(13)

No. 95-559-CSX
Status: GRANTED

Title: Doctor's Associates, Inc. and Nick Lombardi, Petitioners
v.
Paul Casarotto, et ux.

Docketed:
October 4, 1995

Court: Supreme Court of Montana

Counsel for petitioner: Kravitz,Mark R.

Counsel for respondent: Sikes,Lucinda A.

Entry	Date	Note	Proceedings and Orders
1	Oct 2 1995	G	Petition for writ of certiorari filed. (Response due November 22, 1995)
3	Oct 23 1995		Order extending time to file response to petition until November 22, 1995.
4	Nov 21 1995		Brief amici curiae of International Franchise Association, et al. filed.
5	Nov 22 1995		Brief of respondents Paul and Pamela Casarotto in opposition filed.
6	Dec 1 1995		Reply brief of petitioners filed.
7	Dec 6 1995		DISTRIBUTED. January 5, 1996 (Page 15)
8	Jan 5 1996		Petition GRANTED. The brief of petitioners is to be filed with the Clerk and served upon opposing counsel on or before 3 p.m., Friday, February 16, 1996. The brief of respondents is to befiled with the Clerk and served upon opposing counsel on or before 3 p.m., Friday, March 15, 1996. A reply brief, if any, is to be filed purusant to Rule 25.3. Rule 29.2 does not apply. **********
13	Feb 15 1996		Joint appendix filed.
9	Feb 16 1996		SET FOR ARGUMENT TUESDAY, APRIL 16, 1996. (2ND CASE).
10	Feb 16 1996		Brief of petitioners Doctor's Associates, Inc. and Nick Lombardi filed.
11	Feb 16 1996		Brief amicus curiae of American Council of Life Insurance filed.
12	Feb 16 1996		Brief amicus curiae of Kaiser Foundation Health Plan, Inc. filed.
14	Feb 23 1996		Brief amici curiae of International Franchise Association, et al. filed.
15	Mar 12 1996		CIRCULATED.
16	Mar 15 1996	X	Brief of respondents Paul and Pamela Casarotto filed.
17	Mar 15 1996		Lodging consisting of 12 copies of Montana Legislative History submitted by counsel for the repsondents
18	Mar 15 1996	X	Brief amici curiae of American Association of Retired Persons, et al. filed.
19	Mar 20 1996		Record filed.
		*	Original record proceedings Supreme Court of Montana (Box).
20	Mar 25 1996		Record filed.
		*	Original record proceedings Eighth Judicial District Court, Cascade County, Montana (BOX).
21	Apr 4 1996	X	Reply brief of petitioners Doctor's Associates, Inc. and Nick Lombardi filed.

No. 95-559-CSX

Entry	Date	Note	Proceedings and Orders
22	Apr 16 1996		ARGUED.

No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,

Petitioners,

vs.

PAUL CASAROTTO and PAMELA CASAROTTO,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF MONTANA

PETITION FOR A WRIT OF CERTIORARI

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85 pp

QUESTION PRESENTED

Whether Section 2 of the Federal Arbitration Act (9 U.S.C. § 2)--which makes written agreements to arbitrate "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract"--preempts a state law that makes agreements to arbitrate, but not other agreements, unenforceable unless a specific notice of the arbitration agreement is placed on the first page of the contract.

STATEMENT PURSUANT TO RULE 14.1(b)

Daniel L. Hudson, Deb Hudson, and D&D Subway Corporation are parties to the proceedings in the Montana Eighth Judicial District Court. They were not parties to the appeal in the Supreme Court of Montana and are omitted from the caption in this Court.

Doctor's Associates, Inc., the only corporate petitioner, states that it has no parent company and that it has no subsidiaries (other than wholly-owned subsidiaries).

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No.

IN THE

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PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF MONTANA

PETITION FOR A WRIT OF CERTIORARI

Doctor's Associates, Inc. and Nick Lombardi respectfully request that a writ of certiorari issue to review the judgment of the Supreme Court of Montana in this case.

OPINIONS BELOW

The opinion of the Supreme Court of Montana has not yet been reported. It is reprinted in the appendix to this petition at 1a-10a. The prior opinion of the Montana Supreme Court in this case is reported at 268 Mont. 369, 886 P.2d 931. It is reprinted in the appendix to this petition at 11a-46a. The order of the Montana Eighth Judicial District Court is not reported. It is reprinted in the appendix to this petition at 49a-50a.

JURISDICTION

The Supreme Court of Montana entered judgment on August 31, 1995. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257(a).

STATUTORY PROVISIONS INVOLVED

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2, provides:

> **Validity, irrevocability, and enforcement of agreements to arbitrate**
>
> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Section 27-5-114(4), Montana Code Annotated, provides:

> Notice that a contract is subject to arbitration pursuant to this chapter shall be typed in underlined capital letters on the first page of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration.

The full text of Section 27-5-114, which governs the validity of arbitration agreements under Montana law, is set out in the appendix to this petition. Pet. App. 51a.

STATEMENT

A. Introduction

This is the second time that this case has come before this Court. The case arises from the refusal of the Montana

Supreme Court to enforce an agreement by the parties to arbitrate their disputes. Although the agreement met all of the requirements of Section 2 of the Federal Arbitration Act ("FAA"), 9 U.S.C. § 2--which makes arbitration agreements "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract" -- the Montana Supreme Court, in its initial opinion dated December 15, 1994, held that the agreement was unenforceable because it did not comply with a provision of Montana's arbitration act requiring notice that a contract is subject to arbitration to be typed in underlined capital letters on the first page of the contract. *See* Mont. Code Ann. § 27-5-114(4) (1993). In so doing, the court rejected Petitioners' argument that the Montana statute, which applies only to agreements to arbitrate and not other agreements, is preempted by Section 2 of the FAA.

On June 12, 1995, this Court granted Petitioners' petition for a writ of certiorari, vacated the judgment of the Montana Supreme Court, and remanded the case to that court for further consideration in light of this Court's recent decision in *Allied-Bruce Terminix Companies v. Dobson*, 115 S. Ct. 834 (1995). *See Doctor's Associates, Inc. v. Casarotto*, 115 S. Ct. 2552 (1995). Despite this Court's decision to vacate the judgment in light of *Terminix*, the Montana Supreme Court concluded on remand that "we can find nothing in the [*Terminix*] decision which relates to the issues presented to this Court in this case." Pet. App. 6a. The court thus "reaffirm[ed] and reinstate[d]" its December 1994 opinion. Pet. App. 7a. Because *Terminix* makes clear that a state may not invalidate an agreement to arbitrate under a state law--like Montana's--that places arbitration clauses on an unequal footing with other contract terms, *see* 115 S. Ct. at 838-39, 843, Petitioners again seek certiorari to review the judgment below.

B. Factual Background

Petitioner Doctor's Associates, Inc. ("DAI") is the national and international franchisor of Subway sandwich shops.[1] DAI has sold a total of over 8,500 Subway franchises throughout the United States. Pet. App. 49a; *see also id.* 37a (Weber, J., dissenting). Petitioner Nick Lombardi is DAI's development agent in Montana.

On April 25, 1988, respondent Paul Casarotto entered into a franchise agreement with DAI to open a Subway shop in Montana. Pet. App. 13a. The franchise agreement was a standard agreement used by DAI with its franchisees. The agreement contained an express arbitration clause providing that "[a]ny controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration."[2]

Another section of the franchise agreement provided that "[t]his Agreement shall be governed by and construed in accordance with the laws of the State of Connecticut." Pet. App. 15a. Just above the signature block, the agreement provided as follows: "Each of the parties hereto acknowledges that he has read and understands this Agreement and consents to be bound by all of its terms and conditions." Appendix to Brief

[1] During the events in question, DAI was a Connecticut corporation with its principal place of business in Connecticut. As a result of a merger in 1991, it is now a Florida corporation.

[2] The full text of the arbitration clause (Pet. App. 13a-14a) is as follows:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost of such a proceeding will be borne equally by the parties.

for the Appellants, Exhibit 1 (attachment A), *Casarotto v. Lombardi*, 886 P.2d 931 (Mont. 1994).[3] The agreement was executed by DAI and Paul Casarotto.

C. Initial Proceedings Below

A dispute subsequently arose between the parties. Despite the agreement to arbitrate all disputes, however, Casarotto brought suit against DAI, Lombardi and others in the Montana Eighth Judicial District Court, Cascade County.[4] In the suit, he alleged that he had entered into the franchise agreement and had opened a store on the west side of Great Falls in reliance on false representations of DAI and Lombardi that he would have an exclusive right to open a store in a different part of town when that location became available. He also alleged that DAI and Lombardi had interfered with efforts to

[3] Respondent Paul Casarotto filed an affidavit in the Montana state district court, averring that "I read the agreement over before I signed it," although he goes on to state that "no one ever told or explained to me that the agreement contained an arbitration clause or that the agreement was to be interpreted according to the laws of the State of Connecticut." Appendix to Brief for the Appellants, Exhibit 2, ¶ 8, *Casarotto v. Lombardi*, 886 P.2d 931 (Mont. 1994). DAI also provided Casarotto a detailed franchise offering circular that contained the following notice on the first page as required by the Federal Trade Commission: "READ ALL OF YOUR CONTRACT CAREFULLY. BUYING FRANCHISE [sic] IS A COMPLICATED INVESTMENT. TAKE YOUR TIME TO DECIDE. IF POSSIBLE, SHOW YOUR CONTRACT AND THIS INFORMATION TO AN ADVISOR, SUCH AS A LAWYER OR AN ACCOUNTANT." *Id.*, Exhibit 3, at 1. The offering circular also stated that the franchise agreement contained a binding arbitration agreement. *Id.*, Exhibit 3, at 18a.

[4] The suit named Paul Casarotto and his wife, Pamela Casarotto, as plaintiffs. Paul and Pamela Casarotto asserted claims against defendants other than DAI and Lombardi with whom they did not have an arbitration agreement. Those claims were not the subject of the opinions and orders below. With respect to the claims asserted against DAI and against Lombardi as DAI's agent, only Paul Casarotto had entered into the franchise agreement with DAI, and it is clear from the complaint that only he, and not his wife, is asserting claims against DAI and Lombardi. However, the opinions below referred to the plaintiffs in the plural and treated both plaintiffs alike.

sell his store. He asserted state-law claims against DAI and Lombardi for tortious interference with business relations, breach of covenant of good faith and fair dealing, fraud, constructive fraud, negligent misrepresentation, deceit, and violations of the Montana Consumer Protection Act. Pet. App. 13a.

Citing the arbitration provisions in the franchise agreement, DAI and Lombardi moved in the state district court to dismiss or stay the judicial proceedings against them pending arbitration. DAI and Lombardi argued that Section 2 of the FAA required arbitration of the claims, that the FAA preempted any state law impeding enforcement of a contractual agreement to arbitrate, and that, in any event, Montana law was inapplicable to the parties' agreement because the agreement contained the parties' choice of Connecticut law. DAI also filed a Demand for Arbitration with the American Arbitration Association. Pet. App. 14a, 50a.

The Montana district court granted Petitioners' motion to stay the lawsuit as against them pending arbitration. The court found that the parties' franchise agreement involved interstate commerce within the meaning of Section 2, that the claims asserted against DAI and Lombardi were encompassed by the agreement's arbitration clause, and that DAI had properly demanded arbitration of those claims. The court ordered that the claims against DAI and Lombardi "are hereby stayed until the arbitration has been had in accordance with the terms of the arbitration agreement." Pet. App. 49a-50a.

The Montana Supreme Court, sitting en banc (Pet. App. 47a), reversed the district court in a 4-3 decision in December 1994. Although the court did not dispute that the arbitration agreement met the requirements of federal law,[5] it nonetheless refused to enforce the agreement on the ground that it did not

[5] The Montana Supreme Court's opinion did not disturb the trial court's rulings that the parties' agreement to arbitrate involved interstate commerce, that the claims against DAI and Lombardi were encompassed by the agreement, and that DAI had filed a demand for arbitration.

comply with particular state notice requirements applicable only to arbitration agreements. *See* Mont. Code Ann. § 27-5-114(4) (1993). Pet. App. 27a. That statute provides that a contract must contain a notice that it is subject to arbitration in underlined capital letters on the first page of the contract, otherwise "the contract may not be subject to arbitration." The statute, by its terms and as interpreted by the Montana Supreme Court (Pet. App. 19a-20a, 51a), affects the enforceability of arbitration agreements but not other types of contracts.

The decision of the Montana Supreme Court not to enforce the parties' agreement to arbitrate proceeded in several steps. First, before reaching the question of whether the FAA preempts state arbitration laws, the court determined that it would apply Montana, not Connecticut, law to the agreement in this case. Although the parties had explicitly provided in their contract that Connecticut law would govern the agreement, the Montana Supreme Court rejected that selection. Instead, it ruled that Montana's arbitration notice statute (which had no counterpart in Connecticut law) constituted a fundamental public policy that could not be thwarted by the parties' choice of a different state's law. According to the court, the public policy of requiring notice of a contractual arbitration clause reflected state legislative concerns that Montanans receive sufficient notice before agreeing to a dispute resolution procedure--namely, arbitration--that was potentially inconvenient, expensive and devoid of the procedural safeguards of a judicial proceeding. Pet. App. 19a-20a.

Having decided to apply Montana law to the parties' agreement to arbitrate, the Montana Supreme Court next considered whether Montana's arbitration notice statute was preempted by the FAA. The court acknowledged decisions of this Court holding that Section 2 of the FAA created federal substantive law binding on the states on the issue of the enforceability of arbitration agreements. Pet. App. 20a-22a. The Montana Supreme Court nevertheless interpreted this Court's decision in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468

(1989), as retreating from earlier decisions by allowing courts to apply state arbitration laws so long as such laws do not "undermine the goals and policies of the FAA." Pet. App. 23a-25a. The Montana court then concluded that a notice statute ensuring that parties had "knowingly" entered into an arbitration agreement was consistent with the policies underlying the FAA as construed in *Volt*. Pet. App. 26a-27a.[6]

In deciding that Montana's arbitration notice statute was not preempted by Section 2 of the FAA, the Montana Supreme Court declined to follow contrary decisions from three federal courts of appeals and from the Missouri Supreme Court, all of which held that state arbitration notice requirements are preempted by the FAA. The court found those decisions unpersuasive because they either preceded *Volt* or contained little or no reference to *Volt*. The court found more persuasive decisions by intermediate state courts in Indiana and Texas that cited *Volt* in ruling that notice provisions in state arbitration acts are not preempted by the FAA. Pet. App. 26a.[7]

D. Subsequent Proceedings Below

This Court then vacated the judgment of the Montana Supreme Court and remanded for further consideration in light of *Terminix*, which had been decided after the Montana court rendered its decision in this case. *Doctor's Associates, Inc. v. Casarotto*, 115 S. Ct. 2552 (1995). The Montana Supreme

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[6] The court stated that it was of no significance that *Volt* had upheld a court's application of California law to an arbitration agreement where the parties had expressly chosen to abide by California law, whereas in this case the court was applying Montana law despite the parties' choice to be bound by Connecticut law. Pet. App. 25a.

[7] The author of the court's opinion also wrote separately to express his "personal observation" that federal appellate judges had misinterpreted the FAA and thus had unnecessarily and inappropriately deprived individuals of access to a system of justice available only in the courts. Pet. App. 28a-32a. Three of the seven Justices on the Montana Supreme Court dissented from the court's opinion. Pet. App. 33a-46a.

Court ignored Petitioners' request to brief and argue the issues on remand, Pet. App. 9a (Gray, J., dissenting), and, on August 31, 1995, reaffirmed and reinstated its December 1994 opinion.

In its decision on remand, the court first summarized its prior opinion, emphasizing again that its decision was based on an analysis of *Volt* that preemption is determined by whether the notice statute undermines the goals and policies of the FAA. Pet. App. 4a. Observing that this case did not involve a "state law which made arbitration agreements invalid and unenforceable," and further noting that the parties' agreement indisputably involved interstate commerce, the court concluded that "we can find nothing in the [*Terminix*] decision which relates to the issues presented to this Court in this case." Pet. App. 6a. In particular, the court saw nothing in *Terminix* that required it to modify its analysis of *Volt* "that state law is only preempted to the extent that it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" Pet. App. 6a (quoting *Volt*, 489 U.S. at 477).

Three of the court's seven Justices dissented on the basis of the majority's "arrogant and cavalier approach to this important case on remand from the United States Supreme Court," and on the basis of the majority's misreading of *Volt* and *Terminix*'s reaffirmation of the supremacy of the FAA on the issue of enforceability of agreements to arbitrate. Pet. App. 9a-10a. Commenting on the majority's rush to decision without benefit of briefs or argument, the dissent concluded that "one must assume that the Court is simply unwilling to consider any analysis that would require a change in the result it remains determined to reach." Pet. App. 9a.

REASONS FOR GRANTING THE WRIT

This case presents an important issue regarding the scope of Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2. Although that section provides that written arbitration agreements are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any

contract," the Montana Supreme Court refused to enforce the agreement here because it did not comply with a state statute requiring that notice of an agreement to arbitrate (but no other contractual term) be typed in underlined capital letters on the first page of a contract.

This decision merits review for several reasons. To begin with, it is at odds with the language of Section 2 and with the clear teachings of *Terminix* and numerous other decisions of this Court construing that language. Section 2 plainly states that written arbitration agreements involving interstate commerce are to be enforced "save upon such grounds as exist . . . for the revocation of *any* contract." 9 U.S.C. § 2 (emphasis added). This Court has repeatedly read that language--most recently in *Terminix* --to mean that state laws that condition enforcement of arbitration agreements on compliance with particular state requirements are preempted unless they apply to enforcement of contract provisions generally, and not just to arbitration provisions. *See Terminix*, 115 S. Ct. at 838-39, 843; *Perry v. Thomas*, 482 U.S. 483, 489-91 & 492 n.9 (1987); *Southland Corp. v. Keating*, 465 U.S. 1, 10-16 (1984); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Co.*, 460 U.S. 1, 24 (1983). Contrary to the reasoning of the Montana Supreme Court, nothing in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), permits state courts to override the wishes of the contracting parties and impose obstacles to enforcement of arbitration agreements that are inapplicable to other types of agreements. *See, e.g., Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1215-16 (1995); *Terminix*, 115 S. Ct. at 843.

The decision below is also in direct conflict with the decisions of a number of federal courts of appeals, as well as that of another state supreme court. Unlike the court below, those courts followed the language of Section 2 and the decisions of this Court construing that language to hold that Section 2 preempts state laws conditioning enforcement of arbitration agreements on compliance with notice requirements that do not apply to contracts generally. *David L. Threlkeld & Co. v.*

Metallgesellschaft Ltd. (London), 923 F.2d 245, 249-50 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991); *Securities Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1120 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990); *Webb v. R. Rowland & Co.*, 800 F.2d 803, 806-07 (8th Cir. 1986); *Collins Radio Co. v. Ex-Cell-O Corp.*, 467 F.2d 995, 997-99 (8th Cir. 1972); *Bunge Corp. v. Perryville Feed & Produce, Inc.*, 685 S.W.2d 837, 839 (Mo. 1985) (en banc).

Finally, the issues presented here have importance beyond this case. Eight states in addition to Montana have enacted arbitration laws with notice requirements comparable to Montana's or other laws intended to direct particular attention to an arbitration provision in a contract. *See* Part III, *infra*. More generally, numerous states have placed conditions on agreements to arbitrate that do not apply to other contracts. *Id.* Taken collectively, these state laws stand as a direct impediment to the national uniformity contemplated by Section 2, leaving persons transacting business in multiple states subject to the vagaries of inconsistent state arbitration laws. Review by this Court is thus necessary to implement Congress's "inten[t] to foreclose state legislative attempts to undercut the enforceability of arbitration agreements." *Southland*, 465 U.S. at 16.

I. THE FEDERAL ARBITRATION ACT PREEMPTS MONTANA'S STATUTORY RESTRICTIONS ON ENFORCEMENT OF ARBITRATION AGREEMENTS.

The question presented by this petition is straightforward. May Montana refuse to enforce an otherwise valid agreement to arbitrate on the ground that the agreement does not comply with notice requirements applicable to arbitration agreements but not to other types of agreements? The language of Section 2, and this Court's consistent construction of that language, make clear that Montana may not. Section 2 expressly preempts the application of Montana's arbitration notice statute, Mont. Code Ann. § 27-5-114(4) (1993), to agreements involving interstate commerce.

A. The language of Section 2 is plain and unequivocal. With respect to contracts within its ambit--as the contract here, involving an interstate transaction, concededly is--it declares written agreements to arbitrate to be "valid, irrevocable, and enforceable" as a matter of federal law. 9 U.S.C. § 2. To that principle, Section 2 then provides an explicit, and explicitly limited, exception: agreements to arbitrate may be deemed unenforceable "upon such grounds as exist at law or in equity for the revocation of *any* contract." *Id.* (emphasis added). As a matter of plain language, therefore, Section 2 permits courts to apply state laws applicable to contracts generally, but not state laws singling out arbitration agreements for disfavored treatment.

This reading of Section 2 is confirmed by numerous decisions of this Court. As the Court has repeatedly recognized, Section 2 embodies a "liberal federal policy favoring arbitration agreements." *Moses H. Cone*, 460 U.S. at 24. Its "basic purpose . . . is to overcome courts' refusals to enforce agreements to arbitrate." *Terminix*, 115 S. Ct. at 838; *accord Mastrobuono*, 115 S. Ct. at 1215. By enacting the FAA, Congress "intended courts . . . to 'place such agreements upon the same footing as other contracts.'" *Terminix* at 838 (quoting *Volt*, 489 U.S. at 474) (internal quotation marks omitted). It thus "withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Southland*, 465 U.S. at 10; *accord Mastrobuono* at 1216.

The Court has acknowledged only two limitations on the enforceability of arbitration agreements governed by the FAA: "they must be part of a written maritime contract or a contract 'evidencing a transaction involving commerce' and such clauses may be revoked upon 'grounds as exist at law or in equity for the revocation of any contract.'" *Southland*, 465 U.S. at 10-11. The Court has emphasized that it "see[s] nothing in the Act indicating that the broad principle of enforceability [in Section 2] is subject to *any* additional limitations under state law." *Id.* at 11 (emphasis added). As a result, the Court has said that, once the nexus with interstate commerce

is established, state law may be applied to invalidate an arbitration agreement only if the law "arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." *Perry*, 482 U.S. at 493 n.9; *accord Terminix*, 115 S. Ct. at 843. By contrast, "[a] state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement of § 2. A court may not, then, in assessing the rights of litigants to enforce an arbitration agreement, . . . rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding" denying enforcement of the agreement. *Perry*, 482 U.S. at 493 n.9 (citations omitted); *accord Southland*, 465 U.S. at 16-17 n.11.

The Montana Supreme Court refused to acknowledge these principles, despite their reaffirmance last Term in *Terminix*. It is true, as the Montana court noted, that much of the opinion in *Terminix* is devoted to construing the interstate commerce language of Section 2, an issue that is not presented in this case. And it is also true that the Alabama statute at issue in *Terminix* invalidated all arbitration agreements, not just those for which no special notice was given. But the importance of *Terminix* extends beyond its precise holding, for it makes clear again that Section 2 preempts state laws--like Alabama's and Montana's--that single out arbitration agreements from other types of agreements for unfavorable treatment. As the Court stated in describing the scope of Section 2, "States may not . . . decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause." *Terminix*, 115 S. Ct. at 843. And in language that directly controls the disposition of this case, the Court emphasized that "*[t]he Act makes any such state policy unlawful*, for that kind of policy would place arbitration clauses on an unequal 'footing,' directly contrary to the Act's language and Congress's intent." *Id.* (emphasis added).[8]

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[8] Justice O'Connor, in her concurrence, indicated that the effect of the decision in *Terminix* would be to preempt statutes like that upheld by the court below:

(Footnote continued)

The court below paid no heed to these statements, however. Rather, the court held that Montana could do precisely what the FAA prohibits. By its terms, Montana arbitration law makes unenforceable any agreement to arbitrate that is not accompanied by the prescribed notice.[9] The statute does not affect the validity of contracts generally under Montana law; it limits only the enforcement of arbitration agreements as part of a state policy disfavoring arbitration. Indeed, as the Montana Supreme Court candidly acknowledged, the notice statute reflects legislative concern about Montana citizens "entering into an agreement . . . to a procedure as potentially inconvenient, expensive, and devoid of procedural safeguards as the one provided for by the rules of the American Arbitration Association." Pet. App. 20a.[10] This Court noted in

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The reading of § 2 adopted today will displace many state statutes carefully calibrated to protect consumers, see, *e.g.*, Mont. Code Ann. § 27-5-114(2)(b) (1993) (refusing to enforce arbitration clauses in consumer contracts where the consideration is $5,000 or less), and state procedural requirements aimed at ensuring knowing and voluntary consent, see, *e.g.*, S.C. Code Ann. § 15-48-10(a) (Supp. 1993) (*requiring that notice of arbitration provision be prominently placed on first page of contract*).

115 S. Ct. at 843 (emphasis added).

[9] The notice statute, Mont. Code Ann. § 27-5-114(4) (1993), is part of the Montana Uniform Arbitration Act. However, it is a deviation from the Uniform Arbitration Act (1955), 7 U.L.A. 1 (West 1985 & Supp. 1995), which contains no notice requirement. Montana has enacted other provisions refusing to enforce arbitration in certain types of contracts (Pet. App. 51a), which also are deviations from the uniform act. Montana enacted its arbitration act in 1985 in the wake of the Court's decision in *Southland* that states cannot altogether ban arbitration agreements that are otherwise enforceable under Section 2 of the FAA.

[10] This same anti-arbitration policy caused the Montana Supreme Court to make a second, related error: its decision to apply Montana law despite the parties' explicit contractual choice of Connecticut law. The Montana Supreme Court relied on a state policy hostile to arbitration as the reason for applying Montana law to the agreement under conflict-of-laws principles and then proceeding to invalidate the agreement under that same policy. If it were not for the arbitration notice requirement that Petitioners argue is preempted by Section 2, the court below would not have reached

(Footnote continued)

Terminix that it is precisely that type of focused hostility toward arbitration that Congress sought to overcome when it enacted the FAA. 115 S. Ct. at 838.[11]

B. The Montana Supreme Court, in its initial opinion, appeared to concede that the decisions in *Southland* and *Perry*, standing alone, would require enforcement of the arbitration agreement in this case. Pet. App. 20a-23a. The court found its way around *Southland* and *Perry*, however, by holding that *Volt* had limited preemption of state law only to those instances in which enforcement of state law would "undermine the goals and policies of the FAA." Pet. App. 25a; *see also* Pet. App. 4a. But *Volt* did no such thing. The Court in *Volt* had no occasion even to consider the preemptive force of Section 2 with regard to the *enforcement* of arbitration agreements, since the California law chosen by the parties in *Volt* did not render their arbitration agreement unenforceable. As this Court recently explained, *see Mastrobuono*, 115 S. Ct. at 1216, *Volt* held only that the FAA requires courts "to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms." *Volt*, 489 U.S. at 478. In other words, the "FAA's pro-arbitration policy does not operate without regard to the wishes of the contracting parties." *Mastrobuono* at 1216; *see Volt* at 478.

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its conclusion that the Connecticut law chosen by the parties (which has no special notice requirement) was offensive to Montana's public policy. Pet. App. 19a-20a. In any event, because the Montana statute is preempted by Section 2, it is not necessary for this Court to reach out and decide whether Montana's conflict-of-laws analysis was independently flawed by its dependence on a statute evidencing hostility toward arbitration.

[11] As this Court has noted, Congress did not disable the states from applying general principles against unconscionable agreements or unequal bargaining power. *Terminix*, 115 S. Ct. at 843. But a state may not *single out* arbitration agreements for special treatment out of a concern that those agreements in particular may be the product of unequal bargaining power. *Id.*; *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 33 (1991); *Perry*, 482 U.S. at 493 n.9; *Saturn Distribution Corp. v. Williams*, 905 F.2d 719, 726 (4th Cir.), *cert. denied*, 498 U.S. 983 (1990).

The situation here, of course, is just the opposite of that presented in *Volt*. Unlike *Volt*, where the state court applied the law chosen by the parties to the contract, the court here *refused* to apply the law chosen by the parties, stating that it was contrary to Montana public policy as expressed in the arbitration notice statute. Pet. App. 20a. Moreover, this Court noted in *Volt* that the state law at issue *fostered* the federal policy favoring arbitration, by resolving a practical problem arising in multiparty disputes that the FAA failed to address. *Volt*, 489 U.S. at 476 n.5. The Court reached the question of whether the state procedure "would undermine the goals and policies of the FAA" only because the FAA had not "displaced state regulation in [that] area." *Id.* at 477-78. But, while the FAA might be silent about the procedural situation presented in *Volt*, it speaks in the clearest possible terms to the circumstances under which an agreement to arbitrate must be enforced. *Southland*, 465 U.S. at 10-11. [12]

Nothing in *Volt* itself, therefore, detracts from the holdings in *Southland* and *Perry* that Section 2, by its plain language, expressly preempts state laws conditioning enforcement of arbitration agreements on compliance with requirements not applicable to *any* contract. And that reading of *Volt* is confirmed by *Terminix*. *See* 115 S. Ct. at 838-39, 843. While the Montana Supreme Court saw nothing in *Terminix* to affect its

[12] It is true, as the Montana Supreme Court observed, that the FAA does not "occupy the entire field of arbitration." *Volt*, 489 U.S. at 477. *Volt*, for example, dealt with an aspect of arbitration procedure not addressed by the FAA. *Id.* at 476 n.5. But under Section 2 of the FAA, the parties may be assured that their agreement to arbitrate will be enforced so long as the agreement is "[a] written provision in . . . a contract evidencing a transaction involving commerce" that is not revocable "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2; *see Southland*, 465 U.S. at 10-11. Any state law that imposes additional obstacles to enforcement of arbitration agreements is preempted under the Supremacy Clause. *Terminix*, 115 S. Ct. at 838-39, 843; *Perry*, 482 U.S. at 493 n.9; *see also Mastrobuono*, 115 S. Ct. at 1216 (FAA ensures enforcement of agreement to arbitrate punitive damages claims "even if a rule of state law would otherwise exclude such claims from arbitration").

reliance on *Volt* to justify the balancing test that it derived from that decision, this Court in *Terminix* made quite clear that state laws that place arbitration agreements "on an unequal footing" *by definition* undermine the goals of the FAA. *Id.* at 839. Even after *Volt*, therefore, Section 2 must still be read to preempt state laws, like the Montana law, that make an arbitration agreement unenforceable even though another type of agreement would be held valid.

We think, therefore, that the Montana Supreme Court was simply mistaken in refusing to apply to this case the principles reaffirmed in *Terminix*. If that view is correct, then the case might be considered one appropriate for summary reversal. In any event, as we discuss below, the decision of the Montana Supreme Court is contrary to the holdings of several federal and state courts, and the issue itself is of considerable legal and practical importance. Therefore, this Court should, at a minimum, grant plenary review to clarify the power of the states to apply arbitration-specific laws to invalidate arbitration agreements.

II. THE DECISION OF THE MONTANA SUPREME COURT IS IN DIRECT CONFLICT WITH DECISIONS OF THE FIRST, SECOND AND EIGHTH CIRCUITS AND THE HIGHEST COURT OF MISSOURI.

The decision below also directly conflicts with decisions by three federal courts of appeals and the Supreme Court of Missouri. Each of those courts has held that Section 2 preempts state laws imposing notice requirements on agreements to arbitrate.

In *David L. Threlkeld & Co. v. Metallgesellschaft Ltd. (London)*, 923 F.2d 245, 249-50 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991), the Second Circuit held that the FAA preempted a Vermont statute, Vt. Stat. Ann. tit. 12, § 5652(b) (Supp. 1994), prohibiting enforcement of an agreement to arbitrate unless it was accompanied by a prominently

displayed, signed acknowledgment of arbitration in a form prescribed by the statute.[13] Although the court agreed that the form contract in that case did not comply with the "rigorous standard" for arbitration agreements set forth in the Vermont statute, the court held that the statute was preempted by federal law and ordered the parties to arbitrate their dispute. *Id.* at 249. The court found that the FAA required only that an agreement to arbitrate be in writing, a "standard obviously . . . less rigid than that required by the Vermont statute." *Id.* at 250.[14] Because the Vermont statute "directly clash[ed]" with the FAA, and because it "effectively reincarnate[d] the former judicial hostility towards arbitration," the court held that it was preempted and that the arbitration agreement was enforceable. *Id.*

In *Threlkeld*, 923 F.2d at 250, the Second Circuit expressed its agreement with a similar decision by the First Circuit in *Securities Industry Ass'n v. Connolly*, 883 F.2d 1114, 1120 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990). In *Connolly*, the court invalidated Massachusetts regulations that required securities broker-dealers to "fully disclos[e] to the customer in writing the legal effect" of an arbitration clause in a customer account agreement. *Id.* at 1125. The First Circuit ruled that "[t]he FAA prohibits a state from taking more

[13] In that case, the parties had signed the defendant's standard-form customer contract that incorporated by reference the rules of a commodities exchange. Those rules, in turn, provided that any dispute arising out of any contract shall be referred to arbitration in accordance with the rules.

[14] The applicable substantive provision of the FAA in *Threlkeld* was Section 202 of the FAA, 9 U.S.C. § 202, rather than Section 2, because the arbitration agreement involved international commerce. *See Threlkeld*, 923 F.2d at 248, 250. Section 202 and Section 2 are similar in that both require a written agreement involving international or interstate commerce to create an enforceable agreement to arbitrate. While Section 2 also requires that the agreement not be revocable upon such grounds as exist for the revocation of any contract, that "savings" clause is not at issue in this case, as the Montana Supreme Court did not (and, obviously, could not), rely on that clause of Section 2 in applying Montana's arbitration-specific notice requirements. *See* Pet. App. 24a-27a.

stringent action addressed specifically, and limited, to arbitration contracts. *Id.* at 1120. Finding that the regulations "derive their essential meaning from the fact that a contract to arbitrate is at issue," the court held that the regulations were in conflict with the FAA and were therefore preempted. *Id.* at 1123.[15]

The First Circuit acknowledged that Massachusetts might have an interest in providing for greater disclosures between broker-dealers and their customers and for better protection of consumers. The court observed that states are free to act to preserve the integrity of the securities business, but not in ways that treat arbitration agreements more harshly than other standard-form consumer contracts. *Id.* at 1124. Although a state may prefer to hold arbitration agreements to stricter standards, the First Circuit, relying on Section 2, concluded that "[t]hat value judgment was within the congressional domain--and only Congress, not the states, may create exceptions to it." *Id.*; *cf. Terminix*, 115 S. Ct. at 843 (O'Connor J., concurring) (concluding that the Court's decision will displace state arbitration laws intended to protect consumers, including South Carolina's law (like Montana's) that requires notice of arbitration to be prominently placed on first page of contract).

The First Circuit in *Connolly* noted the similarity of the Massachusetts regulations to state statutes that the Eighth Circuit had previously held preempted by the FAA. *See Connolly*, 883 F.2d at 1120. In *Webb v. R. Rowland & Co.*, 800 F.2d 803 (8th Cir. 1986), the Eighth Circuit enforced the arbitration provisions in a securities broker's customer contract even though the contract--which specified that Missouri law applied--did not contain a notice of the arbitration provisions

[15] The author of the Montana Supreme Court's opinions in this case wrote a separate concurrence to the court's initial opinion that harshly criticized the First Circuit's decision in *Connolly*, taking the First Circuit to task for failing to consider "the total lack of procedural safeguards in the arbitration process" and the use of arbitration provisions by national companies to "subvert our system of justice." Pet. App. 30a-32a.

in ten-point capital letters above the signature block, as required by Missouri law, Mo. Rev. Stat. § 435.460 (1994). The court cited *Southland*, 465 U.S. at 10-11, for the principle that Section 2 of the FAA provides the only limitations on the enforceability of an arbitration agreement covered by the Act. Thus, the court held that the Missouri notice statute could not be applied to bar enforcement of the arbitration agreement in the case before it. *Webb*, 800 F.2d at 806-07.[16]

Finally, the Missouri Supreme Court itself has refused to apply the Missouri statute at issue in *Webb* to invalidate an arbitration agreement involving interstate commerce. *Bunge Corp. v. Perryville Feed & Produce, Inc.*, 685 S.W.2d 837 (Mo. 1985) (en banc). The court held that it could not apply the statute to an arbitration agreement within the coverage of the FAA without violating the Supremacy Clause, because the statute "seeks to impose a requirement for contracts to arbitrate which is in addition to the requirements of the Federal Arbitration Act. All that is apparently required under that act is contractual language and format sufficient for an ordinarily written contract." *Id.* at 839 (citation omitted).

These cases, taken together, create a body of law that is in irreconcilable conflict with the decision of the Montana Supreme Court.[17] While the Montana Supreme Court thought

[16] In *Collins Radio Co. v. Ex-Cell-O Corp.*, 467 F.2d 995 (8th Cir. 1972), the Eighth Circuit also construed Section 2 of the FAA as "plainly void[ing] all [state] doctrines of invalidity, unenforceability and revocability which apply only to arbitration agreements." *Id.* at 998. The court therefore enforced an arbitration agreement that specified Texas law as governing, even though the agreement did not comply with a Texas arbitration law that required the signed acknowledgment of counsel to the contracting parties that the agreement to arbitrate was made upon the advice of counsel.

[17] The Montana arbitration notice statute is indistinguishable from the Vermont, Missouri and Texas statutes and Massachusetts regulations that the First, Second and Eighth Circuits and the Missouri Supreme Court have all found preempted by Section 2. Indeed, a federal court in Montana has held that the Montana notice statute is preempted by the FAA. *Snap-On Tools Corp. v. Vetter*, 838 F. Supp. 468, 472 (D. Mont. 1993).

that *Volt* had altered the preemptive scope of the federal act, both the Second Circuit and the First Circuit found preemption *after* the decision in *Volt*. The court in *Connolly*, in fact, expressly (and correctly) distinguished *Volt* on the ground that, unlike the Massachusetts regulations, the California regulations applied in *Volt* "did not impinge on the validity or enforceability of the arbitral contract." *Connolly*, 883 F.2d at 1119 n.3. The Montana Supreme Court has thus embraced an interpretation of the FAA based on *Volt* that is squarely rejected by the First Circuit.[18] The clear and direct conflict between the decision of the Montana Supreme Court and the decisions of federal courts of appeals and the Missouri Supreme Court therefore warrants this Court's review.[19]

[18] In *Saturn Distribution Corp. v. Williams*, 905 F.2d 719, 723-27 (4th Cir.), *cert. denied*, 498 U.S. 983 (1990), the Fourth Circuit considered and rejected the same argument accepted by the Montana Supreme Court: "the notion . . . that the [state] statute may be harmonized with the FAA because it only ensures 'consensual rather than forced arbitration.'" *Id.* at 726 (quoting *Saturn Distribution Corp. v. Williams*, 717 F. Supp. 1147, 1151 (E.D. Va. 1989)). The Fourth Circuit concluded that *Volt* "is not to the contrary." *Id.* While the Virginia statute preempted in *Saturn* imposed restrictions on arbitration different from the notice requirements at issue in this case, the Fourth Circuit's reliance on *Webb* and *Connolly*, *see Saturn*, 905 F.2d at 723-24, strongly indicates that the Fourth Circuit would differ with the Montana Supreme Court on the preemption question presented here.

[19] The Montana Supreme Court recognized that its decision was in conflict with the decisions cited above, but chose instead to follow the lead of two state intermediate appellate courts that had read *Volt* as authority to invalidate arbitration agreements that did not comply with state arbitration notice statutes. Pet. App. 26a; *see American Physicians Service Group Inc. v. Port Lavaca Clinic Associates*, 843 S.W.2d 675, 678 (Tex. Ct. App. 1992) (en banc) ("Texas Act prevails over the FAA"), *writ of error denied* (Tex. Apr. 21, 1993); *Albright v. Edward D. Jones & Co.*, 571 N.E.2d 1329, 1332-33 (Ind. Ct. App. 1991), *transfer denied* (Ind. Feb. 27, 1992), *cert. denied*, 113 S. Ct. 61 (1992). The decision by the Indiana Court of Appeals, although erroneous in its failure to find preemption, was inappropriate for review by this Court because the state court's judgment was ultimately based on the independent state ground that the arbitration agreement did not encompass the plaintiff's claims. *See Albright*, 571 N.E.2d at 1333-34.

III. THE MONTANA SUPREME COURT'S DECISION RAISES ISSUES OF NATIONAL IMPORTANCE.

The decision below, if left standing, would seriously disrupt the national uniformity that Congress sought to achieve by putting arbitration agreements on the same footing as other contracts. Arbitration agreements like the one in this case have become a common feature in business and consumer relationships. Financial institutions, franchisors, manufacturers, and a multitude of other companies conducting interstate businesses now include arbitration agreements in their contracts. *See generally* Henry C. Strickland, *The Federal Arbitration Act's Interstate Commerce Requirement: What's Left for State Arbitration Law?*, 21 Hofstra L. Rev. 385, 429-54 (1992). As the case law indicates, national and international economies have come to rely on arbitration in a variety of circumstances. *See, e.g.*, *Threlkeld*, 923 F.2d at 246-47 (contract between member of foreign commodities exchange and American trader); *Connolly*, 883 F.2d at 1116 (customer agreement with securities broker); *Webb*, 800 F.2d at 804-05 (same); *Collins*, 467 F.2d at 996 (purchase agreement between manufacturer and its supplier of computer parts); *Bunge*, 685 S.W.2d at 838 (commercial contract for bulk purchase of soybeans).

It is thus of particular importance that parties to arbitration agreements be assured that their arbitration agreements are enforceable regardless of whether a particular state is receptive to, or hostile to, arbitration. The decisions of the First, Second and Eighth Circuits and the Missouri Supreme Court, by preempting state arbitration notice requirements, affirmed the validity of standardized arbitration provisions that have flourished as a chosen means of resolving disputes. As this Court has found, Congress sought to confer the advantages of arbitration on consumers and businesses alike, *Terminix*, 115 S. Ct. at 842-43, by providing for "rapid and unobstructed enforcement of arbitration agreements." *Moses H. Cone*, 460 U.S. at 23. But the Montana Supreme Court's decision, along with those of the Texas and Indiana intermediate appellate

courts (see note 19 *supra*), creates new uncertainty in the law that undermines Congress's support of arbitration as an alternative device for dispute resolution.

The rule of law announced by the Montana Supreme Court does not take into account the varying, even conflicting, arbitration laws that exist from state to state and their impact on interstate commerce. State arbitration notice provisions are far from uniform. Montana and three other states impose varying notice requirements for contracts subject to an agreement to arbitrate.[20] An additional five states have enacted differing laws regulating the placement and acknowledgment of arbitration agreements within certain kinds of contracts.[21] Furthermore, numerous states have placed other conditions on agreements to arbitrate that do not apply to contracts generally. Montana, for example, refuses to enforce arbitration

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[20] Mo. Rev. Stat. § 435.460 (1994) (notice that contract contains arbitration agreement must be placed adjacent to signature block in ten-point capital letters); S.C. Code Ann. § 15-48-10(a) (Law. Co-op. Supp. 1993) (notice that contract is subject to arbitration shall be typed in underlined capital letters or rubber-stamped prominently on first page of contract); Vt. Stat. Ann. tit. 12, § 5652(b) (Supp. 1994) (parties must sign written acknowledgment of arbitration that contains language provided in statute and that is prominently displayed in contract).

[21] Ga. Code Ann. § 9-9-2(c)(8), (9) (Michie Supp. 1994) (arbitration provisions in residential real estate contracts and employment contracts must be separately initialed at the time of contract's execution); Iowa Code § 679A.1(2)(c) (1995) (agreement to arbitrate tort claims must be in separate writing executed by parties); R.I. Gen. Laws § 10-3-2 (Supp. 1994) (arbitration provisions in insurance contracts must be placed immediately above parties' signatures); Tenn. Code Ann. § 29-5-302(a) (Supp. 1994) (arbitration clause in contracts relating to farm or residential property must be separately signed or initialed by parties); Tex. Rev. Civ. Stat. Ann. art. 224(b) (West Supp. 1994) (excluding from arbitration act any contract by an individual person for acquisition of property or services where consideration is $50,000 or less unless parties agree in writing to submit to arbitration and such agreement is signed by parties and their attorneys); Tex. Rev. Civ. Stat. Ann. art. 224(c) (West Supp. 1994) (personal injury claims excluded from scope of arbitration act except upon advice of counsel to both parties as evidenced by written agreement signed by counsel to both parties).

agreements in certain types of contracts where the consideration is $5,000 or less. Mont. Code Ann. § 27-5-114(2)(b) (1993), *cited in Terminix*, 115 S. Ct. at 843 (O'Connor, J., concurring). Pet. App. 51a.[22]

The results of Montana's interpretation of the FAA are evident in this case. The Montana Supreme Court, applying its conflict-of-laws principles, rejected the parties' choice of Connecticut law and instead applied the Montana arbitration act.[23] The parties therefore lost the benefit of their agreement to arbitrate because they failed to comply with a state notice statute that they did not anticipate would ever be applied to their agreement. A company doing business nationally cannot know in what state it might be sued and--after the decision below--which state's arbitration notice statute might apply. Although Section 2 of the FAA does subject parties to state laws relating to contracts generally, Congress sought by enacting the FAA to remove special state-imposed obstacles to the parties' attempts to arbitrate their disputes because such differential state law treatment of arbitration provisions would undermine the "declared . . . national policy favoring arbitration." *Southland*, 465 U.S. at 10.

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[22] A state-law exclusion from arbitration for small transactions would exclude a significant percentage of disputes that are now subject to arbitration. "[A]ccording to the American Arbitration Association . . ., more than one-third of its claims involve amounts below $10,000 . . . ." *Terminix*, 115 S. Ct. at 843. Georgia similarly excludes from enforcement under its arbitration act any agreement to arbitrate relating to insurance contracts, loan agreements and consumer financing agreements involving $25,000 or less, as well as all contracts involving consumer transactions. Ga. Code Ann. § 9-9-2(c) (Michie Supp. 1994). Similar limitations on the enforceability of arbitration agreements can be found in many states' laws. *See* Strickland, *supra*, at 402 n.98 (citing statutes from 13 different states); *see also Mastrobuono*, 115 S. Ct. at 1215 (New York law barring awards of punitive damages in arbitration).

[23] Connecticut law is virtually identical to the FAA in the conditions it imposes for enforcing agreements to arbitrate. *See* Conn. Gen. Stat. § 52-408 (1995).

The problems encountered by Petitioners in this case in enforcing their agreement to arbitrate will be exacerbated if other states now adopt Montana's interpretation of the preemptive scope of the FAA.[24] A state such as Alabama that has expressed its hostility toward arbitration by banning enforcement of arbitration agreements, *see Terminix*, 115 S. Ct. at 837, could now express that hostility by enacting new laws imposing specific conditions on enforcing arbitration agreements. In the past, this Court has rejected interpretations of the FAA that "would permit states to override the declared policy requiring enforcement of arbitration agreements." *Southland*, 465 U.S. at 17 n.11. The decision of the Montana Supreme Court resurrects the obstacles that this Court has held were eradicated when Congress enacted legislation making arbitration agreements "valid, irrevocable, and enforceable" as a matter of federal law. 9 U.S.C. § 2.

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[24] Other state courts have applied their state's arbitration notice statute to the case before them, but those decisions made no mention of the FAA or preemption, presumably because no party contended that the arbitration agreement involved interstate commerce. *E.g.*, *Hefele v. Catanzaro*, 727 S.W.2d 475 (Mo. Ct. App. 1987); *A.C. Beals Co. v. Rhode Island Hosp.*, 292 A.2d 865 (R.I. 1972); *Joder Bldg. Corp. v. Lewis*, 569 A.2d 471 (Vt. 1989). At the same time, some state courts have found their own state's notice statutes preempted by the FAA. *E.g.*, *McCarney v. Nearing, Staats, Prelogar & Jones*, 866 S.W.2d 881, 887-88 (Mo. Ct. App. 1993), *transfer denied* (Mo. Jan. 25, 1994); *Woermann Constr. Co. v. Southwestern Bell Tel. Co.*, 846 S.W.2d 790, 792-93 (Mo. Ct. App. 1993); *Godwin v. Stanley Smith & Sons*, 386 S.E.2d 464, 467 (S.C. Ct. App. 1989).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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Dated: September 29, 1995

APPENDIX

APPENDIX A

[Filed August 31, 1995]

IN THE SUPREME COURT
OF THE STATE OF MONTANA
1995

No. 93-488

PAUL CASAROTTO and PAMELA CASAROTTO,

Plaintiffs and Appellants,

v.

NICK LOMBARDI and DOCTOR'S ASSOCIATES, INC.,

Defendants and Respondents,

and

DANIEL L. and DEB HUDSON, and D&D SUBWAY CORPORATION,

Defendants.

Appeal from District Court of the Eighth Judicial District,
In and for the County of Cascade,
The Honorable John M. McCarvel, Judge presiding

Submitted: August 22, 1995
Decided: August 31, 1995

Justice Terry N. Trieweiler delivered the opinion of the Court.

Plaintiffs Paul and Pamela Casarotto filed this suit in the District Court for the Eighth Judicial District in Cascade County to recover damages which they claim were caused by the defendants' breach of contract and tortious conduct. Defendants Nick Lombardi and Doctor's Associates, Inc., (DAI) moved the District Court for an order dismissing plaintiffs' complaint, or in the alternative, staying further judicial proceedings pending arbitration of plaintiffs' claims pursuant to a provision in DAI's franchise agreement with plaintiffs which required that disputes "arising out of or relating to" that contract be settled by arbitration. The District Court granted defendants' motion, and ordered that further judicial proceedings be stayed until arbitration proceedings were completed in accordance with the terms of the parties' agreement. Plaintiffs appealed from that order, and on December 15, 1994, we reversed the order of the District Court and remanded this case to that court for further proceedings. *Casarotto v. Lombardi* (1994), 268 Mont. 369, 886 P.2d 931. Following this Court's decision, the defendants petitioned the Supreme Court of the United States for a writ of certiorari. That petition was granted, and on June 12, 1995, the United States Supreme Court ordered that the December 15, 1994, judgment of this Court be vacated, and remanded this case to the Supreme Court of Montana for further consideration in light of that Court's decision in *Allied-Bruce Terminix Cos. v. Dobson* (1995), 513 U.S. ____, 115 S. Ct. 834, 130 L. Ed. 2d 753. Having further considered our prior decision in light of *Dobson*, we now reaffirm and reinstate our prior opinion.

FACTUAL BACKGROUND

Paul and Pamela Casarotto entered into a franchise agreement with DAI which allowed them to open a Subway Sandwich Shop in Great Falls, Montana. DAI's franchise agreement included on page nine a provision which required that controversies or claims related to the contract shall be settled by arbitration in Bridgeport, Connecticut. However, the franchise agreement did not include notice on the front page to the effect that the contract was subject to arbitration, as required by § 27-5-114(4), MCA.

The Casarottos filed this action in the District Court based on their allegations that DAI breached its agreement with them, defrauded them, and engaged in other tortious conduct, all of which resulted in loss of business and the resulting damage.

DAI moved to dismiss the Casarottos' claim or to stay further judicial proceedings pending arbitration pursuant to the arbitration provision in its franchise agreement. The District Court granted DAI's motion to stay further judicial proceedings pursuant to 9 U.S.C. § 3, which is part of the Federal Arbitration Act found at 9 U.S.C. §§ 1-15 (1988).

On appeal from the District Court's order, we considered whether Montana's notice requirement was preempted by the Federal Arbitration Act in light of the U.S. Supreme Court's recent decision in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University* (1989), 489 U.S. 468, 109 S. Ct. 1248, 103 L. Ed. 2d 488. In that case, the Supreme Court stated that:

> The FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration. But even when Congress has not completely displaced state regulation in an area, state law may nonetheless be preempted to the extent that it actually conflicts with federal law--that is, to the extent that it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 U.S. 52, 67, 61 S.Ct. 399, 404, 85 L.Ed.2d 581 (1941). *The question before us, therefore, is whether application of Cal.Civ.Proc. Code Ann. § 1281.2(c) to stay arbitration under this contract in interstate commerce, in accordance with the terms of the arbitration agreement itself, would undermine the goals and policies of the FAA. We conclude that it would not.*

Volt, 489 U.S. at 477-78, 109 S. Ct. at 1255 (citation omitted; emphasis added).

Based on the cited language from *Volt*, we concluded that the nature of our inquiry was whether Montana's notice requirement found at § 27-5-114(4), MCA, would "undermine the goals and policies of the FAA." We concluded that it does not. *Casarotto*, 886 P.2d at 931. We explained our conclusion as follows:

> Our conclusion that Montana's notice requirement does not undermine the policies of the FAA is based on the Supreme Court's conclusion that it was never Congress's intent when it enacted the FAA to preempt the entire field of arbitration, and its further conclusion that the FAA does not require parties to arbitrate when they have not agreed to do so. That Court held that the purpose of the FAA is simply to enforce arbitration agreements into which parties had entered, and acknowledged that the interpretation of contracts is ordinarily a question of state law. *Volt*, 489 U.S. at 474, 109 S.Ct. at 1253.
>
> Presumably, therefore, the Supreme Court would not find it a threat to the policies of the Federal Arbitration Act for a state to require that before arbitration agreements are enforceable, they be entered knowingly. To hold otherwise would be to infer that arbitration is so onerous as a means of dispute resolution that it can only be foisted upon the uninformed. That would be inconsistent with the conclusion that the parties to the contract are free to decide how their disputes should be resolved.
>
> Montana's notice requirement does not preclude parties from knowingly entering into arbitration agreements, nor do our courts decline to enforce arbitration agreements which are entered into knowingly.
>
> Therefore, we conclude that Montana's notice statute found at § 27-5-114(4), MCA, would not undermine the goals and policies of the FAA, and is not preempted by 9 U.S.C. § 2 (1988).

Casarotto, 886 P.2d at 938-39.

On January 18, 1995, subsequent to our decision in this case, the U.S. Supreme Court decided *Dobson*. On June 12, 1995, the same Court vacated our prior *Casarotto* decision and remanded the matter to this Court for further consideration in light of the *Dobson* decision.

In *Dobson*, the plaintiffs were the assignees of a contract with Terminix for life-time protection against termites. They sued Terminix in Alabama state court when they found their house "swarming with termites." Terminix moved the court for a stay pursuant to § 2 of the Federal Arbitration Act (9 U.S.C. § 2 (1988)) so that arbitration could proceed pursuant to a provision for arbitration in the termite protection plan. The stay was denied. The Supreme Court of Alabama upheld the denial on the basis of Ala. Code § 8-1-41(3) (1993), which made written, predispute arbitration agreements invalid and unenforceable. The Alabama court concluded that its state statute was not preempted by the Federal Arbitration Act because the connection between the termite contract and interstate commerce was too slight.

> In the court's view, the Act applies to a contract only if "'at the time [the parties entered into the contract] and accepted the arbitration clause, they *contemplated* substantial interstate activity.'" Despite some interstate activities (*e.g.*, Allied-Bruce, like Terminix, is a multistate firm and shipped treatment and repair material from out of state), the court found that the parties "contemplated" a transaction that was primarily local and not "substantially" interstate.

Dobson, 115 S. Ct. at 837 (citations omitted).

Before addressing the issue presented, the *Dobson* majority reiterated its conclusion that the purpose of the Federal Arbitration Act was to "overcome judicial hostility to arbitration agreements and that applies in both federal and state courts." *Dobson*, 115 S. Ct. at 835. The Court then went on to

conclude that the language in § 2 of the Act which applied its provisions to any "contract evidencing a transaction involving commerce" had broader significance than the words of art "in commerce," and therefore, covered more than persons or activities "within the flow" of interstate commerce. *Dobson*, 115 S. Ct. at 839. The Court held that the word "involving," like "affecting," signaled an intent on the part of Congress "to exercise Congress's commerce power to the full," *Dobson*, 115 S. Ct. at 841, and secondly that the Act's preemptive force applies to transactions which, in fact, involve interstate commerce, even though a connection to interstate commerce may not have been contemplated by the parties at the time they entered into the agreement. For these reasons, the judgment of the Supreme Court of Alabama was reversed. *Dobson*, 115 S. Ct. at 843.

After careful review, we can find nothing in the *Dobson* decision which relates to the issues presented to this Court in this case. Our prior *Casarotto* decision did not involve state law which made arbitration agreements invalid and unenforceable. Our state law simply requires that the parties be adequately informed of what they are doing before they enter into an arbitration agreement. Our decision did not involve an analysis of what was meant by "involving commerce" or "affecting commerce" or "in commerce." We assumed, in the *Casarotto* decision, that the transaction with which we were concerned involved interstate commerce, and that any state law which frustrated the purposes of the Federal Arbitration Act would be preempted.

Finally, there is no suggestion in the *Dobson* decision that the principles from *Volt* on which we relied have been modified in any way. To our knowledge, it is still the law, therefore, that state law is only preempted to the extent that it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Volt*, 489 U.S. at 477, 109 S. Ct. at 1255 (citing *Hines v. Davidowitz* (1941), 312 U.S. 52, 67, 61 S. Ct. 399, 404, 85 L. Ed. 2d 581).

While the *Dobson* decision does include a discussion extolling the virtues of arbitration as a "less expensive alternative to litigation," *Dobson*, 115 S. Ct. at 843 (apparently based on input from the American Arbitration Association), and while that conclusion is at odds with facts set forth in Justice Trieweiler's concurring opinion to our earlier decision, the concurring opinion was not the basis for our decision.

For these reasons, we conclude, after thorough review of our earlier decision in light of the U.S. Supreme Court's decision in *Dobson*, that the decisions are not inconsistent, and therefore, that there is no basis for modifying or reversing our earlier opinion. We reaffirm and reinstate our opinion dated December 15, 1994, in the above matter, and remand this case to the District Court for further proceedings consistent with this opinion.

/s/ Terry N. Trieweiler
Justice

We concur:

/s/ James C. Nelson
/s/ William E. Hunt, Sr.
/s/ W. William Leaphart
Justices

Justice W. William Leaphart, specially concurring.

Justice John C. Harrison was in the majority in this Court's initial decision in Casarotto v. Lombardi (1994), 268 Mont. 369, 886 P.2d 931. Justice Harrison has since retired. As the successor to Justice Harrison, it is incumbent on me to review that decision in light of the remand from the United States Supreme Court. Having reviewed the *Casarotto* decision, I specially concur with the Court's conclusion that Montana's notice requirement in § 27-5-114(4), MCA, does not undermine the goals and policies of the FAA and is not preempted by 9 U.S.C. § 2 (1988). I have also reviewed the United States Supreme Court's decision in Allied-Bruce Terminix Cos. v. Dobson (1995), 115 S.Ct. 834, 130 L.Ed.2d 753, and I see no reason why the principles enunciated in that decision should have any effect upon this Court's decision in *Casarotto*.

In *Dobson*, the United States Supreme Court held that the FAA preempts anti-arbitration state statutes which invalidate arbitration agreements. Section 27-5-114(4), MCA, cannot be characterized as anti-arbitration nor does it invalidate arbitration agreements. On the contrary, it is one section of Montana's Uniform Arbitration Act which specifically recognizes arbitration agreements: "A written agreement to submit an existing controversy to arbitration is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract." Section 27-5-114(1), MCA. The notice requirement of subsection (4) merely protects the consumer by requiring that notice of an arbitration provision be conspicuously placed on the front page of the contract. This does not undermine the pro-arbitration policy of the FAA. Rather, it furthers the policy of meaningful and consensual arbitration by helping ensure that the consumer who signs what is most often a nonnegotiated, form contract, knowingly agrees to arbitration in the event of a dispute. I see no inconsistency between *Dobson* and our decision in *Casarotto* and I specially concur in the Court's decision to reaffirm and reinstate its December 15, 1994 opinion.

/s/ W. William Leaphart
Justice

Justice Karla M. Gray, dissenting.

I dissent from the Court's opinion and order and its reinstatement of its prior opinion in this case. My dissent is based on the procedures used by the Court in addressing the United States Supreme Court's vacating of our earlier opinion and remanding for our reconsideration based on its decision in Allied-Bruce Terminix Cos. v. Dobson (1995), 115 S.Ct. 834, 130 L.Ed.2d 753. I also dissent from the Court's conclusion that nothing in the *Dobson* case relates to the issues presented to this Court. In dissenting, I also reaffirm and reinstate my earlier dissent in this case.

A remand for reconsideration to this Court from the United States Supreme Court is an uncommon occurrence for which we have no procedural rules or practices in place. Counsel for the parties were left without guidance as to how they should proceed in order to be heard during this phase of the case. Counsel for the defendants/respondents requested the opportunity to brief the issues raised by the United States Supreme Court's remand and to present oral argument. Without so much as a mention of this request, the Court apparently denies it. While one can only speculate on the reasons for such an implicit decision, one must assume that the Court is simply unwilling to consider any analysis that would require a change in the result it remains determined to reach. I cannot join in such an arrogant and cavalier approach to this important case on remand from the United States Supreme Court.

More importantly, I disagree with the Court's conclusion that nothing in *Dobson* relates to the issues before us. While I agree that the substantive issue addressed at length in *Dobson* is not before us here, I read more importance into the early language in *Dobson* than does the Court. In *Dobson*, the United States Supreme Court reiterates the fundamental premise of the Federal Arbitration Act by citing to *Volt*, the very case which this Court erroneously interprets and on which it premises its erroneous decision, for the proposition that "the basic purpose of the Federal Arbitration Act is to overcome courts' refusals to enforce agreements to arbitrate."

Dobson, 115 S.Ct. at 838; citing Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ. (1989), 489 U.S. 468, 474. The Supreme Court goes on to say that "[n]othing significant has changed in the 10 years subsequent to *Southland*; no later cases have eroded *Southland's* authority[.]" *Dobson*, 115 S.Ct. at 839. It is this latter statement on which I believe we must focus in reconsidering our decision here. The Court refuses to do so.

I continue to believe that this Court erroneously interprets *Volt*, which was decided by the Supreme Court five years after *Southland*. *Volt* is clearly distinguishable on its facts from the case before this Court and cannot properly serve as a basis for the result the Court reaches. *Volt* is neither inconsistent with, nor a retrenchment from, *Southland*, as this Court suggested in its earlier opinion and suggests again today. This is the message I take from the Supreme Court's statement in *Dobson* that "no later cases have eroded *Southland's* authority;" this is the portion of this Court's earlier opinion to which I believe the Supreme Court was directing our attention on remand.

For the reasons stated in my earlier dissent, it is my view that application of Montana's notice statute is preempted by the Federal Arbitration Act in this case because application of that statute undercuts, undermines and renders unenforceable the parties' agreement to arbitrate. This view is entirely consistent both with *Southland* and with a proper interpretation of *Volt*. Therefore, I dissent from the Court's opinion and order and reinstate my prior dissent in this case.

/s/ Karla M. Gray
Justice

Chief Justice J.A. Turnage and Justice Fred J. Weber join in the foregoing dissent of Justice Karla M. Gray.

/s/ J.A. Turnage
Chief Justice

/s/ Fred J. Weber
Justice

APPENDIX B

[Filed Dec. 15, 1994]

IN THE SUPREME COURT
OF THE STATE OF MONTANA
1994

No. 93-488

PAUL CASAROTTO and PAMELA CASAROTTO,
Plaintiffs and Appellants,

v.

NICK LOMBARDI and DOCTOR'S ASSOCIATES, INC.,
Defendants and Respondents,

and

DANIEL L. and DEB HUDSON, and
D&D SUBWAY CORPORATION,
Defendants.

Appeal from District Court of the Eighth Judicial District,
In and for the County of Cascade,
The Honorable John M. McCarvel, Judge presiding

Submitted: April 19, 1994

Decided: December 15, 1994

Justice Terry N. Trieweiler delivered the opinion of the Court.

Plaintiffs Paul and Pamela Casarotto filed this suit in the District Court for the Eighth Judicial District in Cascade County to recover damages which they claim were caused by the defendants' breach of contract and tortious conduct. Defendants Nick Lombardi and Doctor's Associates, Inc. (DAI), moved the District Court for an order dismissing plaintiffs' complaint, or in the alternative, staying further judicial proceedings pending arbitration of plaintiffs' claims pursuant to a provision in DAI's franchise agreement with plaintiffs which required that disputes "arising out of or relating to" that contract be settled by arbitration. The District Court granted defendants' motion, and ordered that further judicial proceedings be stayed until arbitration proceedings were completed in accordance with the terms of the parties' agreement. Plaintiffs appeal from that order. We reverse the order of the District Court.

The issues raised on appeal are:

1. Based on conflict of law principles, is the franchise agreement entered into between the Casarottos and DAI governed by Connecticut law or Montana law?

2. If the contract is governed by Montana law, is the notice requirement in § 27-5-114(4), MCA, of Montana's Uniform Arbitration Act, preempted by the Federal Arbitration Act found at 9 U.S.C. §§ 1-15 (1988)?

FACTUAL BACKGROUND

On October 29, 1992, Paul and Pamela Casarotto filed an amended complaint naming Doctor's Associates, Inc., and Nick Lombardi as defendants. For purposes of our review of the District Court's order, we presume the facts alleged in the complaint to be true.

DAI is a Connecticut corporation which owns Subway Sandwich Shop franchises, and Lombardi is their development agent in Montana. The Casarottos entered into a franchise agreement with DAI which allowed them to

open a Subway Sandwich Shop in Great Falls, Montana. However, they were told by Lombardi that their first choice for a location in Great Falls was unavailable.

According to their complaint, the Casarottos agreed to open a shop at a less desirable location, based on a verbal agreement with Lombardi that when their preferred location became available, they would have the exclusive right to open a store at that location. Contrary to that agreement, the preferred location was subsequently awarded by Lombardi and DAI to another franchise. As a result, the Casarottos' business suffered irreparably, and they lost their business, along with the collateral which secured their SBA loan.

This action is based on the Casarottos' allegation that Lombardi and DAI breached their agreement with the Casarottos, defrauded them, breached the covenant of good faith and fair dealing, and engaged in other tortious conduct, all of which directly caused the Casarottos loss of business and the resulting damage.

DAI's franchise agreement with the Casarottos was executed on April 25, 1988. There was no indication on the first page of the contract that it was subject to arbitration. However, paragraph 10(c) of the contract, found on page 9, included the following provision:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost

> of such a proceeding will be born equally by the parties.

On January 29, 1993, DAI moved the District Court to dismiss the Casarottos' complaint, or at least stay further judicial proceedings, pending arbitration pursuant to paragraph 10(c) of the franchise agreement. DAI alleged that the franchise agreement affected interstate commerce, and therefore, was subject to the Federal Arbitration Act found at 9 U.S.C. §§ 1-15 (1988). They sought a stay of proceedings pursuant to § 3 of that Act, which provides in relevant part that:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement . . . .

DAI claimed that Montana law could not be raised as a bar to enforcement of the arbitration provision for two reasons: First, the contract specifically called for the application of Connecticut law; and second, Montana law was preempted by the Federal Arbitration Act.

The Casarottos opposed DAI's motion on the grounds that Montana law applied, in spite of the choice of law provision in the contract, and that based on § 27-5-114 (4), MCA, the contract's arbitration provision was unenforceable because DAI had not provided notice on the first page of the agreement that the contract was subject to arbitration.

On June 2, 1993, the District Court issued its order granting DAI's motion to stay further judicial proceedings pursuant to 9 U.S.C. § 3. The order was made applicable to both DAI and Lombardi, but not to other named defendants who were not parties to the franchise agreement and whose alleged conduct raises other issues. On July 8, 1993, the District Court issued an order pursuant to Rule 54(b), M.R.Civ.P., certifying its June 2 order as final for purposes of appeal. The Casarottos appeal from that order.

ISSUE 1

Based on conflict of law principles, is the franchise agreement entered into between the Casarottos and DAI governed by Connecticut law or Montana law?

Paragraph 12 of the franchise agreement entered into between the parties provides as follows: "This agreement shall be governed by and construed in accordance with the laws of the State of Connecticut and contains the entire understanding of the parties." DAI contends that, therefore, Connecticut law governs our interpretation of the contract and that since Connecticut law is identical to the Federal Arbitration Act *see* Conn. Gen. Stat. § 52-409 (1993), conspicuous notice that the contract was subject to arbitration was not required and we need not concern ourselves with the issue of whether Montana law is preempted.

The Casarottos respond that the issue of whether to apply Connecticut or Montana law involves a conflict of law issue and that the answer can be found in our prior decisions. We agree.

In *Emerson v. Boyd* (1991), 247 Mont. 241, 805 P.2d 587, we cited with approval the Ninth Circuit's decision in *R.J. Williams Co. v. Fort Belknap Housing Authority* (9th Cir. 1983), 719 F.2d 979, which adopted the criteria established in Restatement (Second) of Conflict of Laws § 188 (1971) to determine which jurisdiction's laws apply to a contract where no choice of law is provided for in the contract. Section 188 provides as follows:

(1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in § 6.

(2) In the absence of an effective choice of law by the parties (see § 197), the context to be taken into account in applying the principles of § 6 to determine the law applicable to an issue include:

(a) the place of contracting,

(b) the place of negotiation of the contract,

(c) the place of performance,

(d) the location of the subject matter of the contract, and

(e) the domicil, residence, nationality, place of incorporation and place of business of the parties.

These contracts are to be evaluated according to their relative importance with respect to the particular issue.

(3) If the place of negotiating the contract and the place of performance are in the same state, the local law of this state will usually be applied, except as otherwise provided in §§ 189-199 and 203.

In this case, there is a choice of law provision in the parties' contract. The question is whether it was an "effective" choice. We recently held in *Youngblood v. American States Ins. Co.* (1993), 262 Mont. 391, 394, 866 P.2d 203, 205, that this State's public policy will ultimately determine whether choice of law provisions in contracts are "effective." In that case, we stated:

> Here, the general policy language in the insurance contract requires American States to pay whatever damages are required in Montana; that is, the contract is to be performed in Montana. Therefore, unless a contract term provides otherwise, *Kemp* [*v. Allstate Ins. Co. (1979), 183 Mont. 526, 601 P.2d 20*] and § 28-3-102, MCA, require the application of Montana law because the contract was to be 'performed' in Montana. In this case, however, the insurance contract contains a choice of law provision which requires the application of Oregon subrogation law. . . .
>
> . . . .
>
> . . . [T]he choice of law provision will be enforced unless enforcement of the contract provision requiring application of Oregon law as regards subrogation of medical payments violates Montana's public policy or is against good morals.

Youngblood, 866 P.2d at 205.

Based on our conclusion in that case that subrogation of medical payment benefits was contrary to our public policy, we held that:

> [T]he choice of law provision in the insurance contract would result in medical payment subrogation under Oregon law. Because such subrogation violates Montana's public policy, that term of the insurance contract at issue here is not enforceable.

Youngblood, 866 P.2d at 208.

Restatement (Second) of Conflict of Laws § 187(2) (1971) is consistent with our decision in *Youngblood*, and expands upon the factors to be considered under the circumstances in this case. It provides that:

> (2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either

(a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or

(b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

Adopting § 187, then, as our guide, we first look to § 188 to determine whether Montana law would be applicable absent an "effective" choice of law by the parties.

According to the affidavit of Paul Casarotto filed in opposition to DAI's motion to dismiss, he executed the contract in neither Connecticut nor Montana. It was executed while he was traveling in New York. However, it appears from that same affidavit, and from the allegations in the complaint, that original negotiations were conducted by him in Great Falls, the contract was to be performed in Great Falls, the subject matter of the contract (the Subway Sandwich Shop) was located in Great Falls, and that he and Pamela Casarotto resided in Great Falls at the time that the contract was executed. The only connection to Connecticut was that DAI was incorporated in that state and apparently had its home office in that state at the time of the parties' agreement. We conclude that based upon the application of the criteria set forth in § 188, and our prior decision in *Emerson*, Montana has a materially greater interest than Connecticut in the contract issue that is presented, and that absent an "effective" choice of law by the parties, Montana law would apply.

Our remaining inquiry, then, is whether application of Connecticut law would be contrary to a fundamental

policy of this State by eliminating the requirement that notice be provided when a contract is subject to arbitration.

In *Trammel v. Brotherhood of Locomotive Firemen and Enginemen* (1953), 126 Mont. 400, 409, 253 P.2d 329, 334, we held that the public policy of a state is established by its express legislative enactments. Here, the legislative history for § 27-5-114(4), MCA, makes clear that the legislative committee members considering adoption of the Uniform Arbitration Act had two primary concerns. First, they did not want Montanans to waive their constitutional right of access to Montana's courts unknowingly, and second, they were concerned about Montanans being compelled to arbitrate disputes at distant locations beyond the borders of our State.

The facts in this case, and our recent decision in another case, justify those concerns.

Regardless of the amount in controversy between these parties, the arbitration clause in the Subway Sandwich Shop Franchise Agreement requires that the Casarottos travel thousands of miles to Connecticut to have their dispute arbitrated. Furthermore, it requires that they share equally in the expense of arbitration, regardless of the merits of their claim. Presumably, that expense could be substantial, since under the Commercial Arbitration Rules of the American Arbitration Association (1992), those expenses would, at a minimum, include: the arbitrator's fees and travel expenses, the cost of witnesses chosen by the arbitrator, the American Arbitration Association's administrative charges, and a filing fee of up to $4000, depending on the amount in controversy. For a proceeding involving multiple arbitrators, the administrative fee alone, for which the Casarottos would be responsible, is $150 a day. In addition, since the contract called for the application of Connecticut law, the Casarottos would be required to retain the services of a Connecticut attorney.

In spite of the expense set forth above, the procedural safeguards which have been established in Montana to assure the reliability of the outcome in dispute resolutions are absent in an arbitration proceeding. The extent of pretrial discovery is within the sole discretion of the arbitrator and the rules of evidence are not applicable. The arbitrator does not have to follow any law, and there does not have to be a factual basis for the arbitrator's decision. *See May v. First National Pawn Brokers, Ltd.* (Mont. Dec. 15, 1994), Slip Op. 94-189.

Based upon the determination by the Legislature of this State that the citizens of this State are at least entitled to notice before entering into an agreement which will limit their future resolution of disputes to a procedure as potentially inconvenient, expensive, and devoid of procedural safeguards as the one provided for by the rules of the American Arbitration Association, and the terms of this contract, we conclude that the notice requirement of § 27-5-114, MCA, does establish a fundamental public policy in Montana, and that the application of Connecticut law would be contrary to that policy. Therefore, we conclude that the law of Montana governs the franchise agreement entered into between the Casarottos and Doctor's Associates, Inc.

ISSUE 2

If the contract is governed by Montana law, is the notice requirement in § 27-5-114(4), MCA, of Montana's Uniform Arbitration Act, preempted by the Federal Arbitration Act found at 9 U.S.C. §§ 1-15 (1988)?

DAI contends that even if Montana law is applicable, § 27-5-114(4), MCA, is preempted by the Federal Arbitration Act because it would void an otherwise enforceable arbitration agreement. In support of its argument, DAI relies on U.S. Supreme Court decisions in *Perry v. Thomas* (1987), 482 U.S. 483, 107 S. Ct. 2520, 96 L. Ed. 2d 426, *Southland Corp. v. Keating* (1984), 465

U.S. 1, 104 S. Ct. 852, 79 L. Ed. 2d 1, and *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.* (1983), 460 U.S. 1, 103 S. Ct. 927, 74 L. Ed. 2d 765. These cases have been referred to as "[a] trilogy of United States Supreme Court cases" which "developed the federal policy favoring arbitration and the principle that the FAA is substantive law enacted pursuant to Congress's commerce powers that preempts contrary state provisions." David P. Pierce, *The Federal Arbitration Act: Conflicting Interpretations of its Scope* 61 Cinn. L. Rev. 623, 630 (1992). From this trilogy, *Southland* and *Perry* appear to be closest on point and warrant some discussion.

Southland Corporation was the owner and franchisor of 7-Eleven Convenience Stores. Its standard franchise agreements, like DAI's included an arbitration provision. Southland was sued in California by several of its franchisees, based on claims which included violations of the disclosure requirements of the California Franchise Investment Law, Cal. Corp. Code § 31000, *et seq.* (West 1977). The California Supreme Court held that the Franchise Investment Law required judicial consideration of claims brought under that statute, and therefore, held that arbitration could not be compelled. The U.S. Supreme Court disagreed, and held that:

> In creating a substantive rule applicable in state as well federal courts, Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements. We hold that § 31512 of the California Franchise Investment Law violates the Supremacy Clause.

Southland, 465 U.S. at 16 (footnotes omitted).

In *Perry*, the Supreme Court was called upon to reconcile 9 U.S.C. § 2 which mandates enforcement of arbitration agreements, with § 229 of the California Labor Code, "which provides that actions for the collection of wages may be maintained 'without regard to the existence of

any private agreement to arbitrate.'" *Perry*, 465 U.S. at 484 (quoting Cal. Lab. Code § 229 (West 1971)). In that case, Kenneth Thomas sued his former employer for commissions he claimed were due for the sale of securities. His employer sought to stay the proceedings pursuant to §§ 2 and 4 of the Federal Arbitration Act, based on the arbitration provision found in Thomas's application for employment. *Perry*, 465 U.S. at 484-85. In an opinion affirmed by the California Court of Appeals and the California Supreme Court, the California Superior Court denied the motion to compel arbitration. On appeal, the U.S. Supreme Court held that § 2 of the FAA reflected a strong national policy favoring arbitration agreements, notwithstanding "state substantive or procedural policies to the contrary." *Perry*, 482 U.S. at 489. Citing its decision in *Southland*, the Court held that:

> "Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements." Id. at 16 (footnote omitted). Section 2, therefore, embodies a clear federal policy of requiring arbitration unless the agreement to arbitrate is not part of a contract evidencing interstate commerce or is revocable "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. "We see nothing in the Act indicating that the broad principle of enforceability is subject to any additional limitations under state law." *Keating, supra*, at 11.

Perry, 482 U.S. at 489-90.

As additional authority, DAI cites to our own previous decisions which have enforced arbitration agreements in Montana based on *Southland* and *Perry*. *See Downey v. Christensen* (1992), 251 Mont. 386, 825 P.2d 557; *Vukasin v. D.A. Davidson & Co.* (1990), 241 Mont. 126, 785 P.2d 713; *William Gibson, Jr., Inc. v. James Graff Communications* (1989), 239 Mont. 335, 780 P.2d 1131; *Larsen v. Opie* (1989), 237 Mont. 108, 771 P.2d

977; *Passage v. Prudential-Bache Securities, Inc.* (1986), 223 Mont. 60, 727 P.2d 1298.

The Casarottos, however, contend that *Southland* and *Perry* must be considered in light of the Supreme Court's more recent decision in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University* (1989), 489 U.S. 468, 109 S.Ct. 1248, 103 L.Ed. 2d 488, and that our prior arbitration decisions did not deal with the enforceability of arbitration agreements which violated Montana's statutory law. We agree.

In *Volt*, the parties entered into a construction contract which contained an agreement to arbitrate all disputes between the parties relating to the contract. The contract also provided that it would be governed by the law in the state where the project was located. *Volt*, 489 U.S. at 470.

As a result of a contract dispute between the parties, Stanford filed an action in California Superior Court naming Volt and two other companies involved in the construction project. Volt petitioned the Superior Court to compel arbitration of the dispute. However, the California Arbitration Act found at Cal. Civ. Proc. Code § 1280, *et seq.* (West 1982), contained a provision allowing the court to stay arbitration pending resolution of related litigation. On that basis, the Superior Court denied Volt's motion to compel arbitration, and instead, stayed arbitration proceedings pending outcome of the litigation. The California Court of Appeals affirmed that decision, and the California Supreme Court denied Volt's petition for discretionary review. The U.S. Supreme Court granted review and affirmed the decision of the California courts. *Volt*, 489 U.S. at 471-73.

On appeal, the Supreme Court considered Volt's argument that California's arbitration laws were preempted by the Federal Arbitration Act. In its analysis of the preemption issue, the Supreme Court stated that:

> The FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration. But even when Congress has not completely displaced state regulation in an area, state law may nonetheless be pre-empted to the extent that it actually conflicts with federal law—that is, to the extent that it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). *The question before us, therefore, is whether application of Cal.Civ.Proc. Code Ann. § 1281.2(c) to stay arbitration under this contract in interstate commerce, in accordance with the terms of the arbitration agreement itself, would undermine the goals and policies of the FAA. We conclude that it would not.*

Volt, 489 U.S. at 477-78 (citation omitted; emphasis added).

The Supreme Court explained that the purpose of the Federal Arbitration Act was to enforce lawful agreements entered into by the parties, and not to impose arbitration on the parties involuntarily. It noted that in this case the parties' agreement was to be bound by the arbitration rules from California. Therefore, it held that:

> Where, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA, even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward. By permitting the courts to "rigorously enforce" such agreements according to their terms, see [*Dean Witter Reynolds, Inc. v.*]*Byrd*, [470 U.S.] at 221, we give effect to the contractual rights and expectations of the parties, without doing violence to the policies behind the FAA.

Volt, 489 U.S. at 479.

While the Court in *Volt* applied state laws that had been chosen by the parties in their contract, and this case involves state law which is applied pursuant to conflict of law principles, it has been observed that:

> The real significance of the *Volt* decision is not in the Court's holding, but rather in what the Court failed to hold. For example, the Court found no preemption of the California arbitration law by the FAA. Instead, the Court merely stated that Congress did not intend that the FAA occupy the entire field of arbitration law. Thus, enforcing the California law was merely a procedural issue and did not frustrate the policy behind the FAA of enforcing the agreement.

David P. Pierce, *The Federal Arbitration Act: Conflicting Interpretations of its Scope* 61 Cinn. L. Rev. 623, 635 (1992) (footnotes omitted).

Section 2 of 9 U.S.C. provides that:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract*.

(Emphasis added.)

Based upon the Supreme Court's decision in *Volt*, we conclude that the nature of our inquiry is whether Montana's notice requirement found at § 27-5-114(4), MCA, would "undermine the goals and policies of the FAA." We conclude that it does not.

DAI relies on decisions in *Threlkeld & Co., Inc. v. Metallgesellschaft Ltd.* (2d Cir. 1991), 923 F.2d 245, *Securities Industry Ass'n v. Connolly* (1st Cir. 1989), 883 F.2d 1114, *Webb v. R. Rowland & Co., Inc.* (8th Cir. 1986), 800 F.2d 803, and *Bunge Corp. v. Perryville Feed & Produce, Inc.* (Mo. 1985), 685 S.W.2d 837, in support of its argument that notice provisions are preempted by federal law.

The Casarottos, on the other hand, rely on decisions in *American Physicians v. Port Lavaca Clinic* (Tex. Ct. App. 1992), 843 S.W.2d 675, and *Albright v. Edward D. Jones & Co.* (Ind. Ct. App. 1991), 571 N.E.2d 1329, for the principle that since *Volt*, other courts have held that notice provisions in state arbitration laws are not preempted by the Federal Arbitration Act.

However, the cases cited by the parties either precede the Supreme Court's decision in *Volt*, or contain little or no reference to the *Volt* decision. We conclude that none are persuasive, and we must rely on our own analysis of whether Montana's notice requirement undermines the goals and policies of the FAA.

Our conclusion that Montana's notice requirement does not undermine the policies of the FAA is based on the Supreme Court's conclusion that it was never Congress's intent when it enacted the FAA to preempt the entire field of arbitration, and its further conclusion that the FAA does not require parties to arbitrate when they have not agreed to do so. That Court held that the purpose of the FAA is simply to enforce arbitration agreements into which parties had entered, and acknowledged that the interpretation of contracts is ordinarily a question of state law. *Volt*, 489 U.S. at 474.

Presumably, therefore, the Supreme Court would not find it a threat to the policies of the Federal Arbitration Act for a state to require that before arbitration agreements are enforceable, they be entered knowingly. To

hold otherwise would be to infer that arbitration is so onerous as a means of dispute resolution that it can only be foisted upon the uninformed. That would be inconsistent with the conclusion that the parties to the contract are free to decide how their disputes should be resolved.

Montana's notice requirement does not preclude parties from knowingly entering into arbitration agreements, nor do our courts decline to enforce arbitration agreements which are entered into knowingly.

Therefore, we conclude that Montana's notice statute found at § 27-5-114(4), MCA, would not undermine the goals and policies of the FAA, and is not preempted by 9 U.S.C. § 2 (1988).

Because the agreement of the parties in this case did not comply with Montana's statutory notice requirement, it is not subject to arbitration, according to the law of Montana. The District Court's order dated June 2, 1993, is, therefore, reversed, and this case is remanded to the District Court for further proceedings consistent with this opinion.

/s/ Terry Trieweiler
Justice

We concur:

/s/ John Conway Harrison

/s/ William E. Hunt, Sr.

/s/ James C. Nelson
Justices

Justice Terry N. Trieweiler specially concurring.

The majority opinion sets forth principles of law agreeable to the majority of this Court in language appropriate for judicial precedent. I offer this special concurring opinion as my personal observation regarding many of the federal decisions which have been cited to us as authority.

To those federal judges who consider forced arbitration as the panacea for their "heavy case loads" and who consider the reluctance of state courts to buy into the arbitration program as a sign of intellectual inadequacy, I would like to explain a few things.

In Montana, we are reasonably civilized and have a sophisticated system of justice which has evolved over time and which we continue to develop for the primary purpose of assuring fairness to those people who are subject to its authority.

Over the previous 100 years of our history as a state, our courts have developed rules of evidence for the purpose of assuring that disputes are resolved on the most reliable bases possible.

Based on the presumption that all men and women are fallible and make mistakes, we have developed standards for appellate review which protect litigants from human error or the potential arbitrariness of any one individual.

We believe in the rule of law so that people can plan their commercial and personal affairs. If our trial courts decline to follow those laws, our citizens are assured that this Court will enforce them.

We have rules for venue, and jurisdictional requirements based on the assumption that it is unfair to force people to travel long distances from their homes at great expense and inconvenience to prosecute or defend against lawsuits.

We believe that our courts should be accessible to all, regardless of their economic status, or their social importance, and therefore, provide courts at public expense and guarantee access to everyone.

We have developed liberal rules of discovery (patterned after the federal courts) based on the assumption that the open and candid exchange of information is the surest way to resolve claims on their merits and avoid unnecessary trials.

We have contract laws and tort laws. We have laws to protect our citizens from bad faith, fraud, unfair business practices, and oppression by the many large national corporations who control many aspects of their lives but with whom they have no bargaining power.

While our system of justice and our rules are imperfect, they have as their ultimate purpose one overriding principle. They are intended, and continue to evolve, for the purpose of providing fairness to people, regardless of their wealth or political influence.

What I would like the people in the federal judiciary, especially at the appellate level, to understand is that due to their misinterpretation of congressional intent when it enacted the Federal Arbitration Act, and due to their naive assumption that arbitration provisions and choice of law provisions are knowingly bargained for, all of these procedural safeguards and substantive laws are easily avoided by any party with enough leverage to stick a choice of law and an arbitration provision in its preprinted contract and require the party with inferior bargaining power to sign it.

The procedures we have established, and the laws we have enacted, are either inapplicable or unenforceable in the process we refer to as arbitration.

I am particularly offended by the attitude of federal judges, typified by the remarks of Judge Selya in the First Circuit, which were articulated in *Securities Industry Ass'n v. Connolly* (1st Cir. 1989), 883 F.2d 1114,

cert. denied (1990), 495 U.S. 956, 110 S. Ct. 2559, 109 L. Ed. 2d 742.

Judge Selya considered "[i]ncreased resort to the courts" as the cause for "tumefaction of already-swollen court calendars." He refers to arbitration as "a contractual device that relieves some of the organic pressure by operating as a shunt, allowing parties to resolve disputes outside of the legal system." *Connolly,* 883 F.2d at 1116. He states that "[t]he hope has long been that the Act could serve as a therapy for the ailment of the crowded docket." *Connolly,* 883 F.2d at 1116. He then bemoans that fact that, "[a]s might be expected, there is a rub: the patient, and others in interest, often resist the treatment." *Connolly,* 883 F.2d at 1116.

Judge Selya refers to the preference in the various state jurisdictions to resolve disputes according to traditional notions of fairness, and then suggests that "[t]he FAA was enacted to overcome this 'anachronism'." *Connolly,* 883 F.2d at 1119 (citation omitted). He considers it the role of federal courts to be "on guard for artifices in which the ancient suspicion of arbitration might reappear." *Connolly,* 883 F.2d at 1119.

This type of arrogance not only reflects an intellectual detachment from reality, but a self-serving disregard for the purposes for which courts exist.

With all due respect, Judge Selya's opinion illustrates an all too frequent preoccupation on the part of federal judges with their own case load and a total lack of consideration for the rights of individuals. Nowhere in Judge Selya's lengthy opinion is there any consideration for the total lack of procedural safeguards inherent in the arbitration process. Nowhere in his opinion does he consider the financial hardship that contracts, like the one in this case, impose on people who simply cannot afford to enforce their rights by the process that has been forced upon them. Nowhere does Judge Selya acknowledge that the

"patient" (presumably courts like this one) who resists the "treatment" (presumably the imposition of arbitration in lieu of justice) has a case load typically three times as great as Justice Selya's case load.

The notion by federal judges, like Judge Selya, that people like the Casarottos have knowingly and voluntarily bargained and agreed to resolve their contractual disputes or tort claims by arbitration, is naive at best, and self-serving and cynical at worst. To me, the idea of a contract or agreement suggests mutuality. There is no mutuality in a franchise agreement, a securities brokerage agreement, or in any other of the agreements which typically impose arbitration as the means for resolving disputes. National franchisors, like the defendant in this case, and brokerage firms, who have been the defendants in many other arbitration cases, present form contracts to franchisees and consumers in which choice of law provisions and arbitration provisions are not negotiable, and the consequences of which are not explained. The provision is either accepted, or the business or investment opportunity is denied. Yet these provisions, which are not only approved of, but encouraged by people like Judge Selya, do, in effect, subvert our system of justice as we have come to know it. If any foreign government tried to do the same, we would surely consider it a serious act of aggression.

Furthermore, if the Federal Arbitration Act is to be interpreted as broadly as some of the decisions from our federal courts would suggest, then it presents a serious issue regarding separation of powers. What these interpretations do, in effect, is permit a few major corporations to draft contracts regarding their relationships with others that immunizes them from accountability under the laws of the states where they do business, and by the courts in those states. With a legislative act, the Congress, according to some federal decisions, has written state and federal courts out of business as far as these corporations

are concerned. They are not subject to California's labor laws or franchise laws, they are not subject to our contract laws or tort laws. They are, in effect, above the law.

These insidious erosions of state authority and the judicial process threaten to undermine the rule of law as we know it.

Nothing in our jurisprudence appears more intellectually detached from reality and arrogant than the lament of federal judges who see this system of imposed arbitration as "therapy for their crowded dockets." These decisions have perverted the purpose of the FAA from one to accomplish judicial neutrality, to one of open hostility to any legislative effort to assure that unsophisticated parties to contracts of adhesion at least understand the rights they are giving up.

It seems to me that judges who have let their concern for their own crowded docket overcome their concern for the rights they are entrusted with should step aside and let someone else assume their burdens. The last I checked, there were plenty of capable people willing to do so.

/s/ Terry Trieweiler
Justice

Justice Fred J. Weber dissents as follows:

I respect the majority opinion in its expression of the deeply held conviction that arbitration of the type expressed in the contract in this case should not be enforced in Montana and thereby deprive the parties of access to the court system. The answer to such a judicial approach was stated by the United States Supreme Court in Volt Info. Sciences v. Bd. of Trustees (1989), 489 U.S. 468, 478, 109 S.Ct. 1248, 1255, 103 L.Ed.2d 488, 497, in which the United States Supreme Court stated:

> The Act [Federal Arbitration Act] was designed "to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate," . . . and place such agreements "upon the same footing as other contracts," . . . Section 2 of the Act therefore declares that a written agreement to arbitrate in any contract involving interstate commerce or a maritime transaction "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." (Citations omitted.)

I specifically disagree with the majority opinion's refusal to enforce the agreement to arbitrate in the present case.

Issue I

As stated in the majority opinion: Based on conflict of law principles, is the franchise agreement entered into between the Casarottos and DAI governed by Connecticut law or Montana law?

I point out that the issue as stated by the parties essentially was whether an out-of-state corporation can avoid Montana Arbitration Act's conspicuous notice requirement by claiming preemption under the FAA?

The majority opinion refers to this Court's 1991 case of *Emerson v. Boyd*. In determining whether a contract

dispute arose on an Indian reservation, that case adopted language from *R.J. Williams Co.*, a Ninth Circuit case with regard to the factors to be used to determine whether an action did arise on the reservation. In contrast to the present case, *Emerson v. Boyd* did not contain an agreed choice of law as is present in this case. I do not find this to be appropriate authority.

The majority opinion on this issue concludes that the Montana Legislature had determined that its citizens are entitled to notice before entering into an agreement which will limit their future resolution of disputes to a procedure inconvenient, expensive and devoid of procedural safeguards—and further concludes that the notice requirements of § 27-5-114, MCA, established a fundamental public policy in this State which is contrary to the policy of the Connecticut law. On the basis of those conclusions, the majority opinion further concludes that the law of Montana governs. I do not agree with that conclusion.

The key parts of § 27-5-114, MCA, which apply to this issue are the following:

> Validity of arbitration agreement—exceptions. (1) A written agreement to submit an existing controversy to arbitration is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract.
>
> . . .
>
> (4) Notice that a contract is *subject to arbitration pursuant to this chapter shall be typed in underlined capital letters on the first page* of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration. (Emphasis supplied.)

Our question then becomes whether the contract here is subject to "arbitration pursuant to this chapter" so that the notice must be typed in underlined capital letters on the first page of the contract. Two specific paragraphs

of the contract are controlling here. Section 10(c) of the contract stated in pertinent part:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut, . . .

Section 12 of the agreement further stated:

> 12. This Agreement shall be governed by and construed in accordance with the laws of the State of Connecticut and contains the entire understanding of the parties. Other than the representations contained in the Agreement, the Offering Circular and advertising materials of the Franchisor, no other representations have been made to or relied upon by the Franchisee except as set forth below: (None are set forth)

When the foregoing contract provisions are compared to subsection (4) of § 27-2-114, MCA, it is apparent that these contract provisions do not fit within the statute. There is no statement in the Franchise Agreement which specifies that the contract is subject to arbitration pursuant to Montana law or to the Uniform Arbitration Act as enacted in Montana under §§ 27-5-111 to 115, MCA.

I conclude that the contract provisions are controlling in this instance and that the contract between the parties is not by its terms subject to Montana law or arbitration under Montana law. In fact the reverse is true. As above specified, the agreement requires that the commercial rules of the American Arbitration Association shall be applied in any arbitration, and also provides that the agreement is governed by and construed under the laws of the State of Connecticut. This clearly rebuts any suggestion that this particular contract is subject to arbitration pursuant to the laws of the State of Montana and in

particular § 27-5-114, MCA. I therefore conclude that the notice requirement of § 27-5-114, MCA, does not in any way establish a fundamental public policy which is applicable to the present contract.

I further point out that the reference to Restatement (Second) of Conflict of Laws, § 188 (1971), is applicable only in the absence of an "effective" choice of law and I conclude there was such an effective choice of law in the present case.

Issue II

If the contract is governed by Montana law, is the notice requirement of § 27-5-114(4), MCA, of Montana's Uniform Arbitration Act, preempted by the Federal Arbitration Act found at 9 U.S.C. § 1-15 (1988)?

The majority opinion quotes the following from the 1987 United States Supreme Court opinion of *Perry v. Thomas*:

> . . . Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements. . . . Section 2, therefore, embodies a clear federal policy of requiring arbitration unless the agreement to arbitrate is not part of a contract evidencing interstate commerce . . . *We see nothing in the Act indicating that the broad principle of enforceability is subject to any additional limitations under state law*. . . . (Emphasis supplied.)

The affidavit of the vice president of DAI establishes without contradiction that the present agreement to arbitrate is part of a contract in interstate commerce:

> 5. Before July 1991, DAI was a corporation organized under the laws of the State of Connecticut, with a principal place of business at 325 Bic Drive, Milford, CT 06460. On July 1, 1991, DAI of Florida merged with DAI of Connecticut, leaving DAI of Florida as a surviving corporation.

> 6. DAI has sold a total of 8500 Subway franchises in the United States and estimates that there are approximately 7400 stores in operation world wide.

Clearly the present agreement to arbitrate is part of a contract evidencing interstate commerce so the Federal Arbitration Act is applicable.

The majority opinion analyzes the United States Supreme Court's decision in *Volt* and from that concludes that the nature of the inquiry is whether Montana's notice requirement under § 27-5-114(4), MCA, would undermine the goals and policy of the FAA and further concludes it does not. I disagree with that analysis of *Volt*.

In *Volt*, Volt petitioned the California court to compel arbitration of a dispute and the defendant moved to stay arbitration pursuant to California law. The California statute permitted the court to stay arbitration pending resolution of related litigation between a party to the arbitration agreement and third parties not bound by it. The California court stayed the arbitration proceedings pending the outcome of the litigation. In considering whether the California code section in question was preempted by the FAA, the United States Supreme Court stated:

> The FAA contains no express preemptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration. . . . But even when congress has not completely displaced state regulation in an area, state law may nonetheless be preempted to the extent that it actually conflicts with federal law—that is, to the extent that it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." . . . The question before us, therefore, is whether application of Cal. Civ. Proc. Cod. Ann. § 1281.2(c) to stay arbitration under this contract in interstate com-

merce, in accordance with the terms of the arbitration agreement itself, would undermine the goals and policies of the FAA. We conclude it would not.

. . .

. . . Accordingly, we have recognized that the FAA does not require parties to arbitrate when they have not agreed to do so. See id., at 219, 84 L.Ed.2d 158, 105 S.Ct. 1238. (The Act "does not mandate the arbitration of all claims"), nor does it prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement. *It simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms.* . . (Citations omitted.) (Emphasis supplied.)

Volt, 489 U.S. at 477-78, 109 S.Ct. at 1255, 103 L.Ed. 2d at 499-500. The court further stated and concluded:

> Arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit . . . Where, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of FAA, even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward.

Volt, 489 U.S. at 479, 109 S.Ct. at 1256, 103 L.Ed. at 500. It is essential to keep in mind that the key holding of *Volt* as expressed by the United State Supreme Court was that the agreement to arbitrate should be enforced according to its terms—and that allowed application of the California law which provided for the stay in proceedings where other parties besides the arbitration parties were involved in the case. That conclusion does not assist the majority opinion. The rationale of the *Volt* decision in the present case would require enforcement of the contract as agreed upon by the parties—which would

require application of the American Arbitration Association rules as well as the laws of the State of Connecticut. I conclude that the contract here should be enforced to require application of the American Arbitration Association Rules and the laws of the State of Connecticut under *Volt*.

In addition to the conclusion reached under *Volt*, I will discuss several cases which have concluded that a statutory provision similar to Montana's statutory requirement of a statement in capital letters on page one of a contract is in conflict with the Federal Arbitration Act and therefore not enforceable. In David L. Threlkeld and Co. v. Metallgesellschaft Ltd. (2nd Cir. 1991), 923 F.2d 245, Threlkeld asserted that Vermont law voided any arbitration agreement which does not have a specific acknowledgement of arbitration signed by both parties and where the agreement to arbitrate has not been displayed prominently in the contract. The circuit court acknowledged that Threlkeld was correct in asserting that the contracts did not comply with the rigorous Vermont standard. The circuit court then concluded that the Vermont statute is preempted by federal law and stated:

> Because federal arbitration law governs this dispute, we must determine whether the Vermont statute is sufficiently consistent with federal law that the two may peacefully coexist. . . . The First Circuit has recently held that restrictive provisions similar to those found in the Vermont statute are preempted by federal law. . . .
>
> We agree with the First Circuit that state statutes such as the Vermont statute directly clash with the Convention and with the Arbitration Act because they effectively reincarnate the former judicial hostility towards arbitration. Accordingly *we hold that the Convention and the Arbitration Act preempt the Vermont statute, and that the . . . arbitration pro-*

visions, as drafted, are not enforceable. (Emphasis supplied.)

Threlkeld, 923 F.2d at 250. *Threlkeld* is clear authority for concluding that the Montana statute directly clashes with the Federal Arbitration Act and therefore is not enforceable.

In a similar manner, Bunge Corp. v. Perryville Feed and Produce (Mo.1985), 685 S.W.2d 837, addresses a similar issue. As pointed out by the Missouri court in *Bunge*, the Missouri statute is based on the Uniform Arbitration Act (as is the Montana statute) and contains a provision that each contract shall include a statement in 10 point capital letters which reads substantially as follows: THIS CONTRACT CONTAINS A BINDING ARBITRATION PROVISION WHICH MAY BE ENFORCED BY THE PARTIES. The Missouri Supreme Court then stated:

> It is clear that § 435.460, if applied to this case, seeks to impose a requirement for contracts to arbitrate which is in addition to the requirements of the Federal Arbitration Act. All that is apparently required under that act is contractual language and format sufficient for an ordinary written contract. . . . *If the Missouri statute applies, then a commercial contract sufficient under federal law would be in violation.*

There is a manifest violation of the supremacy clause if our statute is so applied. The Federal Arbitration Act was passed by Congress pursuant to its power to regulate interstate commerce . . . Any requirement of state law which adds a burden not imposed by Congress is in derogation of the Congressional power, and pro tanto invalid. A very recent case so holding is *Southland Corp. v. Keeting*. . .

We do not hold that the Missouri statute is unconstitutional. We simply hold that it may not be

> applied to defeat the arbitration provision of a contract which is within the coverage of the federal statute. . . . (Citations omitted.) (Emphasis supplied.)

Bunge, 685 S.W.2d at 839. The *Bunge* conclusion is directly applicable to our present case. If our Montana statute applies to the present case, then a commercial contract sufficient under federal law would be in violation of the Montana statute even though it meets the requirement of the Federal Arbitration Act. As a result, even if we accept the majority opinion conclusion that the Montana code section applies, I would hold that Montana law may not be applied to defeat the arbitration principles of a contract which is clearly within the coverage of the Federal Arbitration Act.

The District Court held that the Federal Arbitration Act required that the present suit should be stayed until the arbitration has been held in accordance with the terms of the agreement. I would affirm that holding.

/s/ Fred J. Weber
Justice

Chief Justice J. A. Turnage concurs in the foregoing dissent.

/s/ J. A. Turnage
Chief Justice

Justice Karla M. Gray, dissenting.

I respectfully dissent from the Court's opinion on both issues presented therein. I write separately because the reasons for my dissent are not altogether identical to those which form the basis for Justice Weber's dissent.

With regard to issue one, I conclude that the franchise agreement entered into between the Casarottos and DAI was governed by Connecticut law. It is my view that the Court's analysis of this issue is incomplete and erroneous.

I agree with the Court's synopsis of our decision in *Emerson v. Boyd,* and, on the basis that the agreement before us does include a choice of law provision, on the inapplicability of that decision to the case before us. In my view, *Youngblood* also is not on point here, since that case did not relate to whether a statute represents a statement of public policy by the Montana legislature and, if so, the extent of that statement of public policy.

I agree with the Court that Montana has a materially greater interest than Connecticut in the contract issue presented and that, absent an "effective" choice of law by the parties, Montana law would apply. I disagree with the remainder of the Court's discussion and analysis on this issue.

My primary concern is that the Court neither presents nor discusses the specific language contained in the statutory notice requirement. That statute provides that "[n]otice *that a contract is subject to arbitration pursuant to this chapter* shall be typed in underlined capital letters on the first page of the contract; . . . ." Section 27-5-114(4), MCA. By its terms, the franchise agreement before us is subject to Connecticut law, not "this chapter"—the MUAA. The legislature's specific limitation on the applicability of the notice requirement is clear and unambiguous; under such a circumstance, we are obligated to so interpret it (Curtis v. Dist. Court of

21st Jud. Dist. (Mont. 1994), 879 P.2d 1164, 1166, 51 St.Rep. 776, 778) and conclude that the notice requirement is *not* applicable to the contract before us. Since the statute is inapplicable by its terms to the contract, it cannot form the basis of a public policy broad enough to negate the parties' choice of Connecticut law.

The Court does not even address the specific statutory language, preferring to resort inappropriately to generalized legislative history for its overly broad interpretation of the extent to which the notice requirement applies and the extent to which the legislature adopted the notice requirement as a public policy. Had the legislature intended the notice requirement to apply to every arbitration agreement entered into by a citizen or resident of Montana, notwithstanding that some other jurisdiction's law would otherwise apply, it would have done so; it did not. It is inappropriate for the Court to judicially broaden the legislature's clear statute in the guise of a conflict of law analysis.

With regard to issue two, I conclude that even if the Court were correct regarding the applicability of Montana's notice requirement under conflict of law principles, that requirement is preempted by the Federal Arbitration Act (FAA). Therefore, I also dissent from the Court's opinion on this issue.

The Court suggests that the United States Supreme Court's *Volt* decision was a departure from its earlier *Southland/Perry* line of cases. It then presents an inadequate analysis of *Volt*. Finally, the Court concludes, purportedly under a *Volt* analysis, that Montana's notice requirement does not undermine the goals and policies of the FAA. Nothing could be further from the truth.

In *Southland,* the United States Supreme Court was faced with a California statute which required judicial consideration of certain claims brought under it; the California courts held that the statute precluded arbitration

under an agreement containing an arbitration provision. Determining that the FAA was a substantive rule applicable in state courts by which Congress intended "to foreclose state legislative attempts to undercut the enforceability of arbitration agreements," the Supreme Court held that the California statute violated the supremacy clause. *Southland* was decided in 1984.

In 1987, the Supreme Court decided *Perry*, another California case involving a different California statute which—by its terms—provided that legal actions for the collection of wages could be maintained notwithstanding an agreement to arbitrate such claims. Again the California courts denied a motion to compel arbitration under the parties' agreement, favoring their legislature's effort to render arbitration agreements unenforceable. And again the United States Supreme Court reversed, quoting its *Southland* language that Congress intended to foreclose state legislatures from undercutting the enforceability of arbitration agreements. For additional clarity, the Supreme Court added " 'We see nothing in the [FAA] indicating that the broad principle of enforceability is subject to any additional limitations under state law.' " *Perry*, 482 U.S. at 489-90 (citations omitted). *Southland* and *Perry* are, as the Court notes, consistent with each other.

In 1989, the Supreme Court decided *Volt*. There, faced with yet another California statute and another decision from the California courts denying a motion to compel arbitration on the basis of the state statute, the Supreme Court affirmed. Contrary to this Court's suggestion, *Volt* is entirely consistent with—and not a retrenchment from—*Southland* and *Perry*. All three cases require this Court to conclude that Montana's notice requirement is preempted by the FAA.

In *Volt*, the parties had specifically agreed to submit disputes under their contract to arbitration under the California arbitration statutes. The California arbitration

statute at issue in *Volt* differed markedly from those in *Southland* and *Perry*. As noted above, the earlier cases involved statutes which clearly undercut the enforceability of arbitration agreements. In *Volt*, however, the statute—part of the California Arbitration Act—merely allowed a court to *stay* arbitration pending resolution of related litigation; the right to arbitrate remained. The issue before the Supreme Court was the same as in the earlier cases: whether the stay provision would undermine the goals and policies of the FAA.

The Supreme Court reiterated that the purpose of the FAA was to *enforce* arbitration agreements entered into by parties, and specifically noted the parties' agreement to apply California's arbitration rules, one of which permitted the stay of arbitration pending related litigation. On these facts, including the parties' choice of California arbitration law and that that law permitted a stay—but not a voiding—of arbitration, the Supreme Court held that enforcing the California stay provision did not frustrate the policy behind the FAA of enforcing arbitration agreements.

The Court's opinion fails—or refuses—to recognize two important differences between *Volt* and the case presently before us. First, the Supreme Court in *Volt* relied heavily on the fact that the parties had affirmatively chosen California arbitration law, including the stay statute, to govern their agreement. Second, the stay statute did not undercut, undermine or render unenforceable the parties' agreement to arbitrate.

Here, the parties did not affirmatively choose Montana arbitration law, which includes the notice requirement, to govern their agreement. They chose Connecticut law.

Moreover, it is clear under *Southland*, *Perry* and *Volt* that Montana's notice requirement is preempted by the Federal Arbitration Act. The reason for this constitutes the second important difference between this case and

Volt: here, the application of the notice requirement is not merely a procedural matter; indeed, it totally undermines the purposes of the FAA by rendering the parties' arbitration agreement unenforceable. This is precisely the result prohibited by the United States Supreme Court in all three of the cases discussed herein and in the Court's opinion on this issue.

I would affirm the District Court's grant of defendants' motion to stay judicial proceedings pending arbitration of plaintiffs' claims.

/s/ Karla M. Gray
Justice

Chief Justice J.A. Turnage joins in the foregoing dissent of Justice Karla M. Gray.

/s/ J.A. Turnage
Chief Justice

APPENDIX C

[Filed Feb. 17, 1994]

IN THE SUPREME COURT
OF THE STATE OF MONTANA

No. 93-488

PAUL CASAROTTO and PAMELA CASAROTTO,
Plaintiffs and Appellants,

v.

NICK LOMBARDI and DOCTOR'S ASSOCIATES, INC.,
Defendants and Respondents,

and

DANIEL L. and DEB HUDSON, and
D&D SUBWAY CORPORATION,
Defendants.

ORDER

Pursuant to the Internal Operating Rules of this Court, this cause is classified for oral argument before the Court sitting en banc and will be set on a future calendar of this Court.

IT IS ORDERED that counsel for all parties in this appeal are hereby directed to specifically address in oral argument the issue of preemption in the following United States Supreme Court case: *Volt Information Sciences, Inc. vs. Board of Trustees of the Leland Stanford Junior University* (1989), 489 U.S. 468, 103 L.Ed.2d 488, 109 S.Ct. 1248.

This Court will consider receiving amicus curiae briefs relative to this cause.

The Clerk is directed to mail a true copy of this order to counsel of record for all parties and to the Executive Directors of the State Bar of Montana, the Montana Trial Lawyers' Association and the Montana Defense Trial Lawyers' Association.

DATED this 17th day of February, 1994.

For the Court,

By /s/ J.A. Turnage
Chief Justice

APPENDIX D

[Filed Jun. 2, 1993]

MONTANA EIGHTH JUDICIAL DISTRICT COURT
CASCADE COUNTY

No. BDV-92-860

PAUL CASAROTTO and PAMELA CASAROTTO,
Plaintiffs,

vs.

DANIEL L. and DEB HUDSON,
D&D SUBWAY CORPORATION, NICK LOMBARDI,
and DOCTOR'S ASSOCIATES, INC.,
Defendants.

ORDER

This cause is before the Court on the defendants Doctor's Associates, Inc. ("DAI") and Nick Lombardi's motion to dismiss, or in the alternative, to stay pending arbirtation. The Court having considered the briefs, the argument of counsel and the evidence submitted, rules as follows:

1. The plaintiff Paul Casarotto (the "franchisee") and DAI entered into a franchise agreement dated April 25, 1988 that concerned interstate commerce. DAI is the national franchisor of "Subway" sandwich shops and the franchise agreement permits, *inter alia*, the franchisee a license to use the nationally-known and federally-registered "Subway" trademark.

2. The franchise agreement contained a clause requiring that:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Con-

necticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost of such a proceeding will be borne equally by the parties.

3. The claims asserted by the plaintiffs against defendants DAI and its alleged agent Lombardi arise out of and relate to the franchise agreement and are therefore encompassed by the arbitration clause and referable to arbitration.

4. The Federal Arbitration Act requires that if an action is brought upon any issue referable to arbitration under the terms of an arbitration agreement, the suit shall be stayed "until such arbitration has been had in accordance with the terms of the agreement. . . ." 9 U.S.C. § 3. *See also, e.g., Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24-25 (1983); *Downey v. Christensen*, 825 P.2d 557, 559 (Mont. 1992).

5. DAI has demanded arbitration of the plaintiffs' claims under the rules of the American Arbitration Association.

Accordingly, it is ordered and adjudged that plaintiffs' claims against the defendants Doctor's Associates, Inc., and Nick Lombardi are hereby stayed until the arbitration has been had in accordance with the terms of the arbitration agreement.

DONE and ORDERED this 2nd day of June, 1993.

/s/ John M. McCarvel
District Judge

APPENDIX E

STATUTE INVOLVED

Section 27-5-114, Montana Code Annotated

27-5-114. Validity of arbitration agreement—exceptions. (1) A written agreement to submit an existing controversy to arbitration is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract.

(2) A written agreement to submit to arbitration any controversy arising between the parties after the agreement is made is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract. Except as permitted under subsection (3), this subsection does not apply to:

(a) claims arising out of personal injury, whether based on contract or tort;

(b) any contract by an individual for the acquisition of real or personal property, services, or money or credit where the total consideration to be paid or furnished by the individual is $5,000 or less;

(c) any agreement concerning or relating to insurance policies or annuity contracts except for those contracts between insurance companies; or

(d) claims for workers' compensation.

(3) A written agreement between members of a trade or professional organization to submit to arbitration any controversies arising between members of the trade or professional organization after the agreement is made is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract.

(4) Notice that a contract is subject to arbitration pursuant to this chapter shall be typed in underlined capital letters on the first page of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration.

(9)

No. 98-589

In The

Supreme Court of the United States

October Term, 1998

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,

Petitioners,

v.

PAUL CASAROTTO and PAMELA CASAROTTO,

Respondents.

On Petition For A Writ Of Certiorari
To The Supreme Court Of Montana

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether a state court, applying traditional conflict-of-law principles, may enforce a state law requiring disclosure of an arbitration clause in a contract, when the contract specifies that state law shall govern the contract and when the application of the state law would not undermine the goals and policies of the Federal Arbitration Act, 9 U.S.C. § 1, *et seq.*

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Respondents Paul and Pamela Casarotto respectfully request that this Court should deny the Petition for Writ of Certiorari seeking review of the Montana Supreme Court's judgment in this case. That opinion is now reported at 901 P.2d 596 (1995).

STATEMENT OF THE CASE

A. Factual Background

Respondent Paul Casarotto entered into a Franchise Agreement with Petitioner Doctor's Associates, Inc. ("DAI") allowing him to open a Subway Sandwich Shop in Great Falls, Montana. Pet. App. 12a-13a. DAI, then a Connecticut corporation, franchises Subway Sandwich Shops. Pet. App. 12a. Petitioner Nick Lombardi ("Lombardi") is an independent contractor who serves as DAI's Montana Development Agent. Pet. App. 12a.[1]

Page nine of DAI's standard Franchise Agreement, which was entered by Paul Casarotto and DAI, contains an arbitration clause which calls for arbitration of claims

[1] Even though Mr. Lombardi was not a signatory to the franchise agreement, he appears to claim that he is also entitled to arbitration of the Casarottos' claims against him, based on a franchise agreement to which he is not a party. Although DAI refers to Lombardi as its development agent, DAI has been equivocal regarding Lombardi's agency status in the proceedings below. Pet. 4; Appellees' Response Brief at 7-8, 21-22, 26, *Casarotto v. Lombardi*, 886 P.2d 931 (Mont. 1994). The Montana court did not reach the issue as to whether the arbitration clause in DAI's franchise agreement would extend to Casarottos' claims against Lombardi.

in Bridgeport, Connecticut. Pet. App. 2a. The full text of the arbitration clause is set forth at Pet. App. 13a-14a. The Franchise Agreement calls for the application of state law, and designated Connecticut law. Pet. App. 15a.

A dispute arose when Lombardi and DAI awarded Casarottos' preferred location in Great Falls to another franchisee, after agreeing to reserve that site for Casarottos, according to the Complaint. Pet. App. 13a. The Complaint alleges the following: Lombardi informed Casarottos that their preferred location in Great Falls was not yet available. Pet. App. 13a. Casarottos agreed to open a shop at a less desirable location based upon a verbal agreement with Lombardi reserving for Casarottos the exclusive right to open a Subway shop in the preferred location when it became available. Pet. App. 13a. Contrary to that agreement, Lombardi and DAI subsequently awarded the preferred location to another franchisee. Pet. App. 13a. As a result, Casarottos' shop suffered irreparably and they lost their business and the collateral securing their SBA loan. Pet. App. 13a.

Casarottos brought an action in Montana district court in Great Falls to recover damages for tort and contract claims against DAI, Lombardi, and the other franchisee. Pet. App. 12a. The franchise agreement did not comply with the notice provisions of Montana's Uniform Arbitration Act.[2] Pet. App. 2a. The district court

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[2] Pertinent sections of that statute provide:

(2) A written agreement to submit to arbitration any controversy arising between the parties after the agreement is made is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract. . . .

* * *

(4) Notice that a contract is subject to arbitration pursuant to this chapter shall be typed in underlined capital letters on the first page of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration. Mont. Code Ann. § 27-5-114 (1987).

held that the franchise agreement involved interstate commerce and stayed the lawsuit against DAI and Lombardi pending arbitration, pursuant to section 3 of the Federal Arbitration Act ("FAA") (9 U.S.C. § 3). Pet. App. 49a. Relying on this Court's analysis in *Volt Information Sciences v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), the Montana Supreme Court reversed. Pet. App. 2a. This Court granted certiorari, vacated the Montana Supreme Court's decision, and remanded for further consideration in light of its intervening decision, *Allied-Bruce Terminix Cos. v. Dobson*, 115 S.Ct. 834 (1995). *Doctor's Associates, Inc. v. Casarotto*, 115 S.Ct. 2552 (1995). After careful review of this case in light of *Terminix*, the Montana Supreme Court reaffirmed and reinstated its prior decision. Pet. App. 6a-7a. DAI and Lombardi have again petitioned for a writ of certiorari.

B. Initial Decision Below

Applying traditional conflict-of-law principles, the Montana Supreme Court held that Montana law governed the franchise agreement entered into between Casarotto and DAI. Pet. App. 15a-20a. The Montana court

determined that Montana had a materially greater interest than Connecticut in a contract negotiated in Montana, to be performed in Montana, regarding a sandwich shop in Montana, and entered into between a Montana resident and a Connecticut corporation (which has since merged with a Florida corporation, Pet. 4 n.1). Pet. App. 18a. The Montana court then found the contractual provision selecting Connecticut law was not effective because it violated Montana's fundamental public policy requiring disclosure of arbitration clauses, and Montana had a materially greater interest. Pet. App. 18a-20a.

Relying on this Court's analysis in *Volt* and standard implied preemption analysis, the Montana court found that Montana's notice provision is consistent with the goals and policies of the FAA and is therefore not preempted. Pet. App. 26a-27a. The FAA does not contain a preemptive provision or reflect congressional intent to occupy the entire field of arbitration. Pet. App. 24a. Therefore, state laws, like Montana's notice provision, which do not undermine the goals and policies of the FAA, are not preempted. Pet. App. 24a-25a. Because DAI's franchise agreement did not comply with Montana's statutory notice requirements, the agreement is not subject to arbitration according to Montana law. Pet. App. 27a.

DAI and Lombardi petitioned this Court for a writ of certiorari. Pet. App. 2a. This Court summarily vacated the Montana court's decision and remanded for further consideration in light of an intervening United States Supreme Court opinion, *Allied-Bruce Terminix Cos. v. Dobson. Doctor's Associates, Inc. v. Casarotto*, 115 S.Ct. 2552 (1995).

C. Decision on Remand.

After careful review,[3] the Montana Supreme Court concluded its earlier decision was consistent with *Terminix*. Pet. App. 7a. The central disputed issue in *Terminix* was whether the contract at issue involved interstate commerce. Pet. App. 6a. The Montana court presumed this case involved interstate commerce, and any state law which frustrated the purposes of the FAA would be preempted. Pet. App. at 6a. In *Terminix* this Court held the FAA preempted an anti-arbitration state law which flatly invalidated predispute arbitration clauses. Pet. App. 6a. The Montana court noted the challenged statute in this case does not make arbitration agreements unenforceable; it simply requires adequate notice of an arbitration clause in a contract. Pet. App. 6a. Finally, the Montana court noted that *Terminix* in no way modified *Volt*, the decision upon which the Montana court relied. Pet. App. 6a. Accordingly, the Montana court reaffirmed and reinstated its prior decision. Pet. App. 7a.

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[3] Petitioners complain that they were not given the opportunity to brief and argue the interpretation of this single case in front of the Montana court. Pet. App. 9. However, the Montana court allowed extensive briefing (one additional brief per side for a total of five briefs) when initially hearing this case. Neither the Federal Rules of Appellate Procedure nor the Montana Rules of Appellate Procedure make any provision for briefing or argument in cases remanded from this Court for further consideration. We note, however, that federal appellate courts routinely consider new authorities without briefing or argument. Indeed, Rule 28(j), Fed. R. App. P., requires that recently decided cases be presented to the court without argument.

REASONS FOR DENYING THE WRIT

The Petition should be denied because it does not raise issues that warrant review by this Court. The Montana Supreme Court's decision on remand is consistent with the principles enunciated in *Allied-Bruce Terminix Cos. v. Dobson*, 115 S.Ct. 834 (1995). The reaffirmed Montana Supreme Court decision was based on a permissible state court application of state rules of arbitration to a contract in which the parties agreed to abide by state law. This Court does not sit to review a *state court's* interpretation of state rules defining the parameters of arbitration when parties agree to apply state law in an arbitration agreement. *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468, 474 and 479 (1989); *accord, Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S.Ct. 1212, 1217 n.4 (1995) (distinguishing that a *federal* court's interpretation of contract is not entitled to such deference).

Contrary to Petitioners' protestations, the decisions below are consistent with this Court's holdings in both *Terminix*, 115 S.Ct. 834, and *Volt*, 489 U.S. 468. Further, the decisions below do not conflict with caselaw from the Circuits or that of other states. Since the Supreme Court's ruling in *Volt*, no Federal Circuit court or state court of last resort (except Montana) has addressed the applicability of the FAA to state law notice requirements when the parties agreed to apply state law. This question has not received the degree of judicial scrutiny which would warrant issuance of a writ of certiorari.

I. THE MONTANA SUPREME COURT PROPERLY APPLIED STATE RULES OF ARBITRATION, WHICH DO NOT UNDERMINE THE GOALS AND POLICIES OF THE FAA, TO A CONTRACT SELECTING STATE LAW.

The Montana court's decisions below are narrowly drawn to apply state law in a contract selecting state law, and are consistent with both *Terminix* and *Volt*. The parties to the arbitration agreement expressly agreed to apply state law. Pet. App. 15a. The Montana Supreme Court undertook a thorough conflict-of-law analysis, applying standard conflict-of-law principles in reaching its decision to apply Montana law.[4] Pet. App. 15a-20a. Petitioners do not present the Montana Supreme Court's application of Montana law and conflict-of-law analysis for review. They request review solely on the question of whether Section 2 of the FAA preempts Montana's notice requirement. Pet. (i).

The Montana Supreme Court relied on this Court's decision in *Volt* to find that the FAA did not preempt Montana's notice requirement. The Montana Supreme Court stated:

> Our conclusion that Montana's notice requirement does not undermine the policies of the

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[4] Similarly, in *Volt*, the California courts determined that the parties' choice of law provision incorporated California rules of arbitration. 489 U.S. at 472. The contracting parties in *Volt* specified, "[t]he contract shall be governed by the law of the place where the project is located." *Id.* at 470. As the contract was performed on the Stanford University campus, over appellants arguments, the California courts determined California law, including its rules of arbitration, applied. *Id.* at 470, 474.

> FAA is based on the Supreme Court's conclusion that its was never Congress's intent when it enacted the FAA to preempt the entire field of arbitration, and its further conclusion that the FAA does not require parties to arbitrate when they have not agreed to do so. The Court held that the purpose of the FAA is simply to enforce arbitration agreements into which parties had entered, and acknowledge that the interpretation of contracts is ordinarily a question of state law.

Pet. App. 16a, *citing Volt*, 489 U.S. at 474. Nothing in *Terminix* upset these cited principles. Pet. App. 6a.

Petitioners concede the primary issue in *Terminix*, construing the interstate commerce language of Section 2 of the FAA, is not at issue in this case. Pet. 13. In fact, the Montana court acknowledged this case involved interstate commerce and that any state law which frustrated the purposes of the FAA would be preempted. Pet. App. 6a.

Nor do the Montana decisions infringe upon the pro-arbitration policy enunciated in *Terminix* and *Volt*. While the preempted statute in *Terminix* invalidated all predispute arbitration clauses, the Montana statute specifically recognizes the enforceability of such arbitration agreements; it merely requires notice of an arbitration clause in a contract, to allow parties to be adequately informed. Pet. App. 6a. The Montana court presumed that this state requirement would not be a threat to the policies of the FAA. Pet. App. 4a. To hold otherwise would run contrary to the conclusion that contracting parties are free to determine how their disputes will be resolved. Pet. App. 4a. Further, such a holding would suggest that arbitration

was so onerous that it could only be thrust upon the uninformed. Pet. App. 4a.

The Montana Supreme Court decisions were based on a permissible state court application of standard conflict-of-law principles and carefully calibrated state rules of arbitration to a contract in which the parties agreed to abide by state law. This Court has indicated that it will not set aside a state court's interpretation of the laws of the state where the contract is to be performed. *Volt*, 489 U.S. at 474; *accord*, *Mastrobuono*, 115 S.Ct. at 1217 n.4. Thus, this Court should not sit to review the matters of state law addressed by the Montana Supreme Court in this case.

II. THE DECISION OF THE MONTANA SUPREME COURT IS IN CONCERT WITH EXISTING CASE-LAW.

In attempting to demonstrate a conflict requiring resolution by this Court, Petitioners mischaracterize the holdings of the Montana Supreme Court and other cited decisions. In fact, the authorities which Petitioners rely on are readily distinguished from the instant proceedings because they i) do not include the preemption analysis in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), or ii) do not involve contractual provisions which select state law. The Montana court correctly recognized these cases are not persuasive. Pet. App. 26a. The authority relied on by DAI is inapposite.

DAI's attempt to portray a conflict based on pre-*Volt* cases, which have lost their authority in light of *Volt*,

should fail. Two cited cases which purportedly conflict with the decisions below were decided before *Volt*: *Webb v. R. Rowland & Co.*, 800 F.2d 803 (8th Cir. 1986) and *Bunge Corp. v. Perryville Feed & Produce, Inc.*, 685 S.W.2d 837 (Mo. 1985). In *Webb* the Eighth Circuit applied a pre-*Volt* analysis to a contract which invoked Missouri law. 800 F.2d at 806. *Volt* clarifies that when the parties have agreed to be bound by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA. Pet. App. 14a. Applying this Court's preemption analysis as articulated in *Volt*, the Eighth Circuit should reach a different decision regarding the Missouri statute.

Similarly, in *Bunge Corp.*, a decision four years before *Volt*, the Missouri Supreme Court found a contractual dispute subject to the rules and regulations of the National Grain and Feed Association was subject to arbitration. 685 S.W.2d at 838. Like the Montana court, the Missouri court acknowledged that Missouri's statutory notice requirements could not be applied to undermine the FAA. *Id.* at 839. However, the Missouri court refrained from invalidating Missouri's statute, stating, "[w]e do not have to decide, and we do not decide, whether an arbitration agreement *governed by Missouri law* is unenforceable in all events. . . . " *Id.* at 839 (emphasis supplied). Thus the Missouri court sidestepped the decision addressed squarely by the Montana Supreme Court in this case. Despite Petitioners' arguments, there is no conflict in these decisions.

Furthermore, the decisions of the Montana Supreme Court addressed a distinct issue from Petitioners' post-*Volt* authority in which the parties did not invoke

state law. In *David L. Threlkeld & Co. v. Metallgesellschaft Ltd. (London)*, 923 F.2d 245, 247 and 250 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991), the parties agreed to arbitration in accordance with the rules and regulations of the London Metals Exchange. Accordingly, the Second Circuit applied the international convention (9 U.S.C. § 202), a discrete section of the FAA.[5] Similarly, where parties agreed to be bound by the rules of Federal Arbitration Act, rather than the law of any state, the federal district court in Montana appropriately applied those rules. *Snap-On Tools Corp. v. Vetter*, 838 F. Supp. 468 (D. Mont. 1993). These decisions, enforcing contracts according to those rules by which the parties agreed to be bound, are in accord with the Montana Supreme Court decisions in the instant case.

Another cited case, *Securities Industry Ass'n v. Connolly*, 883 F.2d 1114 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990), simply did not address the parties' ability to invoke state law. In that case, the First Circuit held that the FAA preempted Massachusetts regulations concerning predispute arbitration agreements for securities brokers. Unlike the present case, no consideration was given to the ability of the parties to invoke state law through a

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[5] Unlike the current case, the decision in *Threlkeld* involved international commerce, an area in which the policy favoring arbitration is "even stronger" and "applies with special force." *Threlkeld*, 923 F.2d 248, *citing Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985). Additionally, *Threlkeld* applied Section 202 of the FAA, 9 U.S.C. § 202, rather than Section 2, at issue in this case.

choice-of-law provision. Thus *Connolly* addresses a distinct issue from that presented in this case where franchisor invoked state law by the terms of its own franchise agreement.

The Montana decisions are squarely consistent with *Volt*, and the principles enunciated in *Terminix*. The decisions below are distinguishable from the cases cited by Petitioners. They do not directly conflict with any decision of this Court, nor of any federal court of appeals. There is no split in the circuits nor an intolerable conflict between the decisions of the highest state courts.

Moreover, and without conceding the point, even if one were inclined towards the view that the Montana Supreme Court's decision conflicts with rulings by other courts, the "conflict" Petitioners allege is plainly tolerable at this time. Try as Petitioners might, they could only identify three post-*Volt* cases, in addition to this case, from state supreme courts or federal appellate courts in which the validity of state notice requirements has been litigated. This proceeding is the only one in which the parties selected state law. Significantly, there is no conflict between the decision below and any ruling of the Ninth Circuit, such that a different result would be mandated depending upon whether a case is filed in state court or federal court.[6] *Compare American Airlines, Inc. v. Wolens,*

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[6] In a footnote, petitioners cite *Snap-On Tools Corp. v. Vetter*, 838 F. Supp. 468 (D. Mont. 1993), as a case where the Montana notice statute was preempted by the FAA, but that case is distinguishable, as the parties there agreed to be governed by federal law, such that the Montana notice law could not take precedence. *Id.* at 472.

115 S.Ct. 817 (1995), and *Edenfield v. Fane*, 113 S.Ct. 1792 (1993) (granting review in cases where state and federal appellate courts reached opposite conclusions).

If anything, the weakness in Petitioners' line of attack is illustrated by their reliance, at least in part, on dire predictions about what state legislatures and other courts might do if this lone decision from the Montana Supreme Court is allowed to stand (Pet. App. 22-25), a tacit concession that the legal issue they raise has not yet matured to the point that review by this Court is appropriate at this time. Thus, when all is said and done, Petitioners' real quarrel with the decision below is the fact that they lost. That is not sufficient reason for this Court to grant review.

III. THE MONTANA SUPREME COURT DECISION IS NOT A GOOD VEHICLE FOR ADDRESSING THE CONCERNS RAISED BY PETITIONERS.

The Petitioners attempt to portray the Montana decision as one of national importance. Pet. 22-25. However, Montana is the only state to hold that the state notice provision is applicable when parties select state law in their contract, and no federal circuit court has ruled on this particular issue after *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989). Should the states rise and follow Montana's lead regarding the preemptive scope of the FAA, as Petitioners predict (Pet. at 25), actual conflicts may appear and the issue will then be more appropriate for this Court's review. One of those future cases may provide a more straightforward vehicle, without the need for

this Court to engage in a conflict-of-law analysis or to decide whether the acts of the franchisor's development agent are subject to arbitration under the franchise agreement.

Nor, unlike the situation this Court confronted in *Terminix*, is this case part of a larger pattern of hostility toward arbitration on the part of a state legislature and supreme court.[7] To the contrary, the statute at issue in this case has served as the basis for vigorous enforcement of arbitration agreements in Montana.[8] As Petitioners readily conceded below, the Montana Supreme Court,

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[7] After *Allied-Bruce Terminix Companies, Inc. v. Dobson*, 115 S.Ct. 834 (1995), this Court also vacated three other Alabama Supreme Court decisions that refused to give effect to arbitration provisions: *Home Buyers Warranty Corp. II v. Lopez*, 115 S.Ct. 930 (1995); *Terminix Int'l, Ltd. P'ship v. Jackson*, 115 S.Ct. 930 (1995); and *So. Health Corp. of Hamilton, Inc. v. Lorance*, 115 S.Ct. 930 (1995).

[8] *See, e.g., Chor v. Piper, Jaffray & Hopwood, Inc.*, 862 P.2d 26 (Mont. 1993) (finding contracts requiring arbitration are as enforceable in Montana as any other contracts); *Downey v. Christensen*, 825 P.2d 557 (Mont. 1992) (holding franchisor's participation in discovery did not waive right to compel arbitration); *Vukasin v. D.A. Davidson & Co.*, 785 P.2d 713 (Mont. 1990) (finding arbitration clause in annual review document an enforceable part of employment agreement); *Gibson v. James Graff Communications, Inc.*, 780 P.2d 1131 (Mont. 1989) (finding contract involving interstate commerce subject to the FAA); *Larsen v. Opie*, 771 P.2d 977 (Mont. 1989) (holding claim of fraud in the inducement of the execution of a contract containing an arbitration clause is to be decided by arbitration); *Passage v. Prudential-Bache Securities*, 727 P.2d 1298 (Mont. 1986), *cert. denied*, 480 U.S. 905 (1987) (holding parties subject to arbitration even if customer agreement at issue was found to be a contract of adhesion).

"has consistently upheld the federal policy in favor of arbitration and applied the FAA to arbitration clauses in contracts involving interstate commerce." Brief for the Appellees Nick Lombardi and Doctor's Associates, Inc., at 9, *Casarotto v. Lombardi*, 886 P.2d 931 (Mont. 1994). In light of their own concessions below, Petitioners' assertions of Montana's hostility toward arbitration (Pet. 14-15) ring hollow.

This Court has consistently held that the FAA only places arbitration agreements on the same footing as other contracts, but does not make super contracts out of such agreements.[9] Petitioner DAI routinely drafts the contracts in question. It certainly remains within its power to control the forum for resolving disputes by deciding whether to include a choice-of-law provision selecting or barring the application of state law and its concomitant rules of arbitration.

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[9] *Allied-Bruce Terminix Companies, Inc.*, 115 S.Ct. at 840; *Volt*, 489 U.S. at 474-75 (stating the FAA does not give parties powers in excess of any other contract clause); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985) (recognizing a party may exclude certain claims from the scope of their arbitration agreement); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Co.*, 460 U.S. 1 (1983) (finding the FAA puts arbitration clauses on the same footing as other contracts and reflecting a general federal policy favoring arbitration); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) (holding the Federal Arbitration Act makes arbitration agreements "as enforceable as other contracts, but not more so").

CONCLUSION

For the reasons set forth above, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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Dated November 22, 1995.

No. 95-559

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,

Petitioners,

vs.

PAUL CASAROTTO and PAMELA CASAROTTO,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF MONTANA

REPLY BRIEF FOR PETITIONERS

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DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,

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ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF MONTANA

REPLY BRIEF FOR PETITIONERS

I. THE MONTANA NOTICE STATUTE IS PREEMPTED BY THE FEDERAL ARBITRATION ACT.

Respondents do not dispute either of the two points that are essential to answering the straightforward question presented by the petition. One, the parties entered into a written agreement to arbitrate involving interstate commerce that met all of the requirements of Section 2 of the Federal Arbitration Act ("FAA"), which makes written agreements to arbitrate "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Two, the Montana Supreme Court refused to enforce the agreement to arbitrate on the ground that it did not comply with a notice requirement under Montana law that is applicable only to arbitration agreements and not to other types of agreements. Under the plain and unequivocal

language of Section 2 and the decisions of this Court, those two points alone are sufficient to find preemption of the Montana notice statute. *See* Pet. 11-17.

Rather than address those two central points, respondents instead attempt to justify the Montana Supreme Court's decision on the basis of a rationale not even relied upon by that court. According to respondents, the Montana court applied the Montana arbitration notice requirements because the parties had "expressly agreed to apply state law" to their franchise agreement. Br. in Opp. 7. Therefore, according to respondents, the Montana Supreme Court's decision not to enforce the agreement to arbitrate on the basis of Montana law was appropriate under *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), because the decision below purportedly was based on "a state court's application of standard conflict-of-law principles and carefully calibrated state rules of arbitration to a contract in which the parties *agreed to abide by state law*." Br. in Opp. 9 (emphasis added).

There are, however, several obvious problems with respondents' argument. First, the parties did not agree to apply just any "state law" to their agreement; the choice-of-law clause in the franchise agreement expressly provided that the agreement "shall be governed by and construed in accordance with the laws of the State of Connecticut." Pet. App. 15a. Respondents do not dispute that Connecticut law has no notice requirement comparable to Montana's. Thus, it is undisputed that the parties' agreement to arbitrate is enforceable under the state law chosen by the parties. *See* Conn. Gen. Stat. § 52-408 (1995).[1]

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[1] As is common practice, the parties' agreement to arbitrate also provided that any arbitration proceedings would be "in accordance with the Commercial Arbitration Rules of the American Arbitration Association." Pet. App. 13a. This Court has looked to the arbitration rules incorporated by reference in an arbitration agreement when determining the scope of the agreement. *See Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1218 (1995). Respondents do not even address the parties' *(Footnote continued)*

Second, the Montana Supreme Court did not base its decision on a finding that the parties *intended* to apply Montana law to their agreement; nor could it have done so given the parties' unambiguous choice of Connecticut law. Instead, the Montana Supreme Court refused to apply the law chosen by the parties, precisely because to do so "would be contrary to a fundamental policy of this State by eliminating the requirement that notice be provided when a contract is subject to arbitration." Pet. App. 18a-19a.[2]

Third, therefore, respondents' reliance on *Volt* simply does not hold up. Unlike the situation in *Volt* where the state court applied the law chosen by the parties in their contract, the court in this case did just the opposite: it *refused* to enforce the state law that the parties had selected in their contract. Indeed, the court below very clearly distinguished this case from *Volt* by stating as follows: "While the Court in *Volt* applied state laws that had been chosen by the parties in their contract, . . . this case involves state law which is applied pursuant to conflict of law principles . . . ." Pet. App. 25a. Because the parties here chose a law other than Montana's, it can hardly be said that applying Montana law to invalidate the parties' agreement to arbitrate enforces the intent of the parties, which was the rationale for the decision in *Volt*. *See Volt*, 489 U.S. at 478; *Mastrobuono v. Shearson Lehman Hutton,*

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agreement to abide by the rules of the American Arbitration Association, which--like Connecticut law--do not impose any arbitration notice requirement.

[2] Respondents' comment that it is within the power of Doctor's Associates, Inc. ("DAI") to include in its franchise agreements a provision to avoid the application of state arbitration law, Br. in Opp. 15, is disingenuous given that DAI did just that in this instance by selecting Connecticut law and the rules of the American Arbitration Association in lieu of any other state's law. It is therefore impossible to fathom what more respondents believe DAI could have done to avoid application of Montana law. Of course, under the analysis employed by the Montana Supreme Court, Montana law would apply to the parties' agreement to arbitrate regardless of the law selected by the parties.

Inc., 115 S. Ct. 1212, 1216 (1995). And, because respondents' argument begins and ends with the decidedly false assumption that the parties here intended the Montana notice statute to govern their relationship--an assumption not even indulged in by the Montana Supreme Court--they are left with no defense of the decision below.[3]

What the Montana Supreme Court did decide is that Montana law, even when *not* chosen by the parties (and, more particularly, even when the parties had chosen a different state's law), could invalidate an agreement to arbitrate despite the fact that the Montana law was arbitration-specific and did not govern contracts generally. The sole basis of that decision was a misreading of *Volt* that the preemptive scope of Section 2 is limited to laws that "undermine the goals and policies of the FAA" and that the notice statute does not fall within that category. Pet. App. 25a. That misreading of *Volt* has already been thoroughly addressed in the petition,[4] and respondents

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[3] Under the recent decision in *Mastrobuono*, Montana's notice statute would be preempted even if, hypothetically, the parties *had* agreed to let Montana law govern their franchise agreement. In *Mastrobuono*, the Court characterized a choice-of-law provision similar to the one here as merely serving as "a substitute for the conflict-of-laws analysis that otherwise would determine what law to apply to disputes arising out of the contractual relationship." 115 S. Ct. at 1217. The Court found "untenable" an interpretation of the choice-of-law clause that would put the clause in conflict with the contract's arbitration clause. *Id.* at 1219. It would be even more absurd, and in conflict with the federal policy favoring arbitration and construing ambiguities in favor of arbitration (*see id.* at 1218 & n.8), to rule on the basis of a choice-of-law clause that the parties agreed to an arbitration clause in their franchise agreement at the same time as they intended to incorporate Montana law invalidating that arbitration clause for failure to include the prescribed notice on the first page of the agreement. Certainly, *Volt* does not dictate such a bizarre result, and the Montana Supreme Court did not reach that result, as it applied Montana law contrary to the parties' intent.

[4] Briefly, *Volt* did not address whether an arbitration agreement should be enforced; it dealt only with whether a state law governing the timing of arbitration could be enforced by a state court when the parties had chosen that law to govern their agreement, and where the state law fostered the

(Footnote continued)

have said nothing to question petitioners' analysis that state laws conditioning enforcement of arbitration agreements on compliance with particular state requirements are preempted unless they apply to contract provisions generally, and not just to arbitration provisions.

While respondents baldly state that the Montana court's decision is in harmony with *Terminix*, Br. in Opp. 7, 8, they do not and cannot reconcile the decision below with *Terminix*'s reaffirmation of the preemptive scope of Section 2 as recognized in this Court's earlier decisions. *See Terminix*, 115 S. Ct. at 838-39; *Perry v. Thomas*, 482 U.S. 483, 489-91 & 492 n.9 (1987); *Southland Corp. v. Keating*, 465 U.S. 1, 10-16 (1984); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Co.*, 460 U.S. 1, 24 (1983). Respondents do not even acknowledge the language in *Terminix*, quoted on page 13 of the petition, that "States may not . . . decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. *The Act makes any such state policy unlawful* . . . ." *Terminix*, 115 S. Ct. at 843 (emphasis added). Instead, like the Montana court, respondents ignore the quoted passage and extol the virtues of a notice statute that admittedly applies only to arbitration agreements and not to other contract terms. *See* Br. in Opp. 8-9. Respondents, therefore, cannot avoid the inescapable conclusion that the notice statute is preempted by Section 2.

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federal policy favoring arbitration by addressing a practical problem that the FAA failed to address. *See* 489 U.S. at 476 n.5, 478. It is still the case that Section 2 preempts state laws that place arbitration agreements on an unequal footing with other contracts, as such laws are "*directly* contrary to the Act's language and Congress's intent." *Allied-Bruce Terminix Companies v. Dobson*, 115 S. Ct. 834, 843 (1995) (emphasis added). Respondents do not take issue with petitioners' analysis of the Montana notice statute as placing arbitration agreements on a different footing from other contracts. Nevertheless, even if respondents (and the Montana Supreme Court) were correct in their interpretation of *Volt*, the resulting tension between *Volt* and *Terminix* would itself warrant this Court's review.

II. THIS CASE IS APPROPRIATE FOR REVIEW.

Respondents attempt to minimize the conflict between the decision below and the decisions of the U.S. Courts of Appeals for the First, Second and Eighth Circuits and the Missouri Supreme Court. *See* Br. in Opp. 9-13. They do so principally on the ground that the parties here "selected state law" but that the parties in the cases cited by petitioners did not so agree. *See* Br. in Opp. 12. Because, as we have discussed, the parties did *not* agree to be bound by the Montana notice statute relied on by the court below, respondents' effort to distinguish the contrary authority falls of its own weight. Moreover, as explained in the petition, both the Second and First Circuits found preemption of notice provisions *after Volt*, with the latter expressly distinguishing *Volt* in finding preemption under Section 2. *See David L. Threlkeld & Co. v. Metallgesellschaft Ltd. (London)*, 923 F.2d 245, 249-50 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991); *Securities Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1119 n.3 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990).

Thus, the conflict between the courts below is real and substantial. Moreover, the issue is of considerable importance. If the decision of the Montana Supreme Court is allowed to stand, other jurisdictions hostile to arbitration may feel free to follow Montana's erroneous interpretation and application of *Volt* and refuse to enforce arbitration agreements on the basis of state-law requirements that are not applicable to contracts generally. Indeed, having previously vacated the judgment below and remanded the case for reconsideration in light of *Terminix*, a decision now by this Court not to review the decision reinstated below could mistakenly be seen as a signal to other courts that the Montana court was correct in its interpretation of the preemptive scope of Section 2. Such a result would inevitably disrupt the national uniformity that Congress sought to achieve in enacting the FAA.

Respondents argue that the Court should deny review and wait for a future case that "may provide a more straightforward vehicle, without the need for this Court to engage in a

conflict-of-law analysis." Br. in Opp. 13-14. But this Court need not engage in any conflict-of-law analysis to resolve the straightforward question presented by the petition. While, as stated in the petition, petitioners believe that the Montana court erred in its conflicts analysis, it is unnecessary for this Court to reach out and decide that issue because the Montana notice statute, which concededly applies only to agreements to arbitrate and not to contracts generally, is in any event preempted by Section 2. *See* Pet. 14 n.10.[5]

Respondents finally contend that review by this Court is unnecessary because the Montana legislature and high court have not demonstrated "hostility" toward arbitration. Br. in Opp. 14-15. But the court below itself acknowledged that the notice statute embodies Montana public policy that is suspicious of arbitration as inconvenient, expensive and devoid of the procedural safeguards of a judicial proceeding. Pet. App. 19a-20a. That attitude seems "hostile" in any normal sense of that term. In any event, the fact remains that the notice statute places agreements to arbitrate on a different footing from other agreements, and for that reason may not be applied to agreements to arbitrate that, like the one here, meet all of the requirements for enforceability under the FAA. *See Terminix*, 115 S. Ct. at 838.

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[5] Respondents also argue that this case is an inappropriate vehicle for reaching the issue presented in the petition because the Court will be required to decide whether petitioner Nick Lombardi, who was not a signatory to the agreement to arbitrate, may enforce the agreement as DAI's agent. Br. in Opp. 14; *see also id.* at 1 n.1. The Montana trial court, however, ruled that the claims against Lombardi were encompassed by the arbitration agreement and that the claims against Lombardi should be stayed pending arbitration. Pet. App. 50a. The Montana Supreme Court did not reach that specific issue. *See* Pet. App. 15a. This Court can therefore decide the issue presented in the petition without concerning itself with whether the Montana trial court erred by staying the claims against Lombardi. That issue can be raised by respondents on remand if still appropriate. In any event, respondents' arguments regarding Lombardi have no bearing on the petition of DAI.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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Dated: December 1, 1995

(2)

No. 95-559

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,

Petitioners,

v.

PAUL CASAROTTO and PAMELA CASAROTTO,

Respondents.

On Petition for a Writ of Certiorari to the Supreme Court of Montana

BRIEF FOR THE INTERNATIONAL FRANCHISE ASSOCIATION AND THE SECURITIES INDUSTRY ASSOCIATION, AS AMICI CURIAE SUPPORTING PETITIONERS

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BRIEF FOR THE INTERNATIONAL FRANCHISE ASSOCIATION AND THE SECURITIES INDUSTRY ASSOCIATION, AS AMICI CURIAE SUPPORTING PETITIONERS

INTEREST OF THE AMICI CURIAE

The International Franchise Association ("IFA"), founded in 1960, is the oldest and largest trade association in the world representing the interests of franchising. IFA has more than 750 franchisor members and, since first inviting franchisees to join in 1993, has already attracted more than 27,000 franchisee members. IFA serves as a resource center for current and prospective franchisors and franchisees, state and federal government agencies, and the public. IFA also represents the interests of franchising before legisla-

tures, the courts, and the public. The Association has been instrumental in promoting balanced legislation to regulate franchising practices in the United States.

A franchise is a contractual relationship in which the franchisor, the owner of a business concept and associated trademarks or service marks, authorizes a franchisee to conduct a business that is identified by the franchisor's marks and uses the franchisor's format and operating system. The contractual relationship is defined by a franchise or license agreement, which sets forth the respective obligations of the franchisor and franchisee. To promote uniformity in their franchise networks, franchisors utilize standardized agreements. However, such "form" agreements are frequently subject to negotiation. An increasing number of franchising companies, in an effort to resolve disputes with their franchisees in the least costly, least disruptive and most expeditious manner possible, include in their franchise agreements an undertaking to resolve disputes by arbitration, binding on both the franchisor and the franchisee. Such agreements obligate the parties to arbitrate disputes, usually under the auspices of the American Arbitration Association or similar organization, and often in the home state of the franchisor. In the past year alone, almost 400 arbitrations involving franchise relationships were initiated with the American Arbitration Association.

The Security Industry Association ("SIA") is a not-for profit corporation formed under the laws of Delaware. SIA is the securities industry trade association representing the interests of more than 700 securities firms in North America, which collectively account for 90% of securities firms' revenue in the United States.

The relationship between SIA members and their customers, particularly those who borrow money from members, or who trade in options, is sometimes governed by a written

agreement which contains a clause requiring the arbitration of disputes. Most of these agreements also contain a choice of law provision. SIA has a deep concern that these agreements be enforced in accordance with the terms of the Federal Arbitration Act ("FAA"). SIA has been a successful plaintiff against the Commonwealth of Massachusetts and the State of Florida in cases to enforce arbitration clauses despite restrictive state laws or regulations. Consistent enforcement of arbitration agreements is important to both SIA members and their customers since inconsistent enforcement of the FAA will lead to uncertainty and confusion for both parties to the contract.

Historically, many state courts and state legislatures have looked with disfavor on arbitration, especially when it occurred as the result of a pre-dispute agreement to arbitrate. Whether this reluctance to honor agreements to arbitrate stemmed from the belief that arbitration did not afford the same procedural or substantive safeguards as litigation, or whether it grew out of the states' desire to preserve in-state forums for their citizens, the end result was that arbitration agreements were routinely disregarded. With the passage of the FAA and rigorous enforcement of arbitration agreements under the FAA, especially by federal courts, most state courts and legislatures grudgingly accepted arbitration as a legitimate means of resolving disputes. In the past several years, however, a backlash has occurred. A number of states, including Montana, have enacted statutes under the guise of ensuring that arbitration agreements are freely entered into that seriously undermine the enforceability of agreements to arbitrate, and courts have upheld the validity of these statutes despite the preemptive reach of the FAA. One of the most prevalent examples of such legislation is the Montana statute that is the subject of the Montana Supreme Court's two decisions

below.[1] That statute requires that notice of the existence of an agreement to resolve disputes by arbitration be displayed on the first page of the contract in underlined, capital letters, a requirement that is applicable only to arbitration agreements, not to contracts generally. While federal courts have consistently struck down anti-arbitration statutes of this type on preemption grounds, a growing number of state courts, of which the Montana Supreme Court is but the latest example, have held otherwise, permitting states to single out arbitration agreements for unfavorable treatment.

Amici are vitally concerned about this case because permitting the most recent decision of the Montana Supreme Court to stand, particularly after this Court's summary vacatur and remand of the case for consideration in light of *Allied-Bruce Terminix Companies, Inc. v. Dobson*, 115 S. Ct. 834 (1995), will encourage other state courts and legislatures to undertake similar steps to undercut the enforceability of agreements to arbitrate and further thwart the strong federal policy favoring arbitration. As a result, franchisors and securities firms that include arbitration provisions in their form agreements will either be forced to tailor their agreements to the laws of 50 different states or forgo the many advantages inherent in the arbitration process. Even now, the inconsistent treatment of arbitration agreements caused by state notice provisions introduces

[1] The Montana Supreme Court's most recent opinion in this case, dated August 31, 1995, together with the special concurrence and dissent, is printed as Appendix A to the Petition for a Writ of Certiorari filed with the Court in this case. The Montana Supreme Court's initial opinion in this case, dated December 15, 1994, together with the special concurrence and dissents, is printed as Appendix B to the Petition for a Writ of Certiorari. References to the lower court's opinions are designated "App. A" and "App. B," respectively, followed by a page reference.

great uncertainty into the enforcement of those agreements and spawns satellite litigation over the enforceability of the notice provisions that threatens to erase the benefits of economy and efficiency that arbitration was originally intended to produce.

Pursuant to Rule 37.2 of the Rules of this Court, IFA and SIA, respectfully submit this brief as *amici curiae* in support of petitioners. Because many IFA members, both franchisors and franchisees, and many securities firms, utilize arbitration as a means of resolving disputes, IFA and SIA have a substantial interest in the outcome of this case and are able to provide an additional and broader prospective on the issues presented. IFA and SIA believe this brief will assist the Court in analyzing and resolving these issues. The parties have consented to the filing of this brief, and their written consents have been filed with the Clerk of Court.

SUMMARY OF ARGUMENT

In the decision below, the Montana Supreme Court persists in underestimating the preemptive reach of Section 2 of the FAA by holding that Montana's notice requirement for arbitration agreements does not violate the Supremacy Clause. In doing so, the Montana Supreme Court continues to disregard two controlling decisions of this Court, *Southland Corp. v. Keating*, 465 U.S. 1 (1984), and *Perry v. Thomas*, 482 U.S. 483 (1987), both of which held that states may not restrict the enforceability of agreements to arbitrate except on "grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Since Montana's notice requirement is directed exclusively at arbitration provisions and not at any other contractual terms, it is preempted by the FAA. In addition to conflicting with *Southland* and *Perry*, the Montana Supreme Court's decision also runs directly contrary to the decisions of the three federal

courts of appeals that have addressed the issue, all of which held that state arbitration notice requirements are preempted by the FAA. Instead of following these decisions, the court below in its initial opinion relied on two intermediate state courts in Indiana and Texas that upheld similar notice provisions. Review of the decision below is necessary to signal to state courts and legislatures that, for purposes of preemption under the FAA, burdening the enforceability of arbitration agreements with a notice provision is no different than declaring those agreements unenforceable *per se*.

By maintaining that Montana's notice provision does not undermine the goals and policies of the FAA because it ensures consensual arbitration, the Montana Supreme Court also continues to distort this Court's holding in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989). The decision in *Volt* was premised on the notion that the primary purpose of the FAA is to enforce privately negotiated agreements to arbitrate, even where those agreements allow for arbitration to be stayed pending the resolution of related litigation. Because the parties here chose the AAA's Commercial Arbitration Rules and Connecticut law, not Montana law, to govern their arbitration agreement, *Volt* requires that their choice be upheld and not, as the Montana Supreme Court reasoned, that another state's law be substituted that would invalidate the parties' agreement to arbitrate. In addition, although in *Volt* this Court observed that the FAA does not entirely preempt state arbitration laws and in particular state laws governing the procedures under which arbitration is conducted, the Montana Supreme Court perverted this holding into a license to enforce a state arbitration law that went to the very substance of the right to arbitrate, prohibiting arbitration from occurring altogether. The Montana Supreme Court's conclusion that the FAA

mandates the enforcement only of those arbitration agreements that are entered into "knowingly," which Montana's notice provision is purportedly designed to promote, flies in the face of the FAA's insistence that arbitration agreements be placed on the same footing as other agreements. Because of the purported solicitude for arbitration of the majority of the Montana Supreme Court, when in fact its decision and the statute it enforced are based on hostility to arbitration agreements, it is crucial that this Court grant review of the Montana Supreme Court's most recent decision in this case to discourage similar attempts by state courts and legislatures to undermine the FAA on the pretext of furthering its goals and policies.

The Montana Supreme Court's decisions below are also premised on judicial and legislative hostility to arbitration, which has long been discredited by this Court in view of the many advantages that arbitration affords over traditional litigation. These advantages include speed, economy, adjudicative expertise and the capacity to preserve long-term relationships once the dispute is resolved. To enforce statutes like Montana's either would deprive the parties to a franchise relationship of these advantages altogether, or would seriously impede the use of arbitration in the franchise relationship by forcing franchisors to tailor their contract documents to meet the arbitration requirements of 50 different states. Moreover, the Montana Supreme Court's reasoning is based on unsupported and unfounded assumptions regarding the negotiability of arbitration agreements and the role of forum-selection clauses in those agreements.

The popularity and growth of arbitration has been exponential in recent years, as more and more businesses utilize this effective dispute resolution technique to avoid the cost and delay associated with traditional litigation. As a result, review of the decisions below, which introduce rationales that substantially curtail the enforceability of agreements

to arbitrate and raise issues of great importance under the FAA and the Supremacy Clause, will have enormous significance for a large and growing segment of American business. These are compelling reasons for this Court's review.

ARGUMENT

I.

THIS COURT SHOULD DECIDE WHETHER A STATE STATUTORY NOTICE PROVISION FOR ARBITRATION IS PREEMPTED BY THE FEDERAL ARBITRATION ACT

In maintaining that the FAA does not preempt Montana's statute requiring that a contract containing an arbitration agreement include a conspicuous notice to that effect on the face of the contract, the Montana Supreme Court continues to disregard two of this Court's controlling precedents and a substantial number of lower federal court decisions that flatly refute the Montana Supreme Court's holding. In so doing, the Montana Supreme Court has severely restricted the preemptive reach of the FAA. Moreover, to justify its hostility to arbitration, the Montana Supreme Court persists in distorting this Court's holding in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), to the point of emasculating the enforceability of agreements to arbitrate under the FAA.

A. The Montana Supreme Court's Decision Disregards Prior Decisions Of This Court And Other Lower Federal Courts

In the decision below, the Montana Supreme Court "reaffirm[ed] and reinstate[d]" its prior holding that the Montana notice provision is not preempted by Section 2 of the FAA because the notice requirement does not undermine the goals and policies of the FAA. App. A at 7a. In so doing, however, the Montana Supreme Court continues to disregard this Court's controlling decisions in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), and *Perry v. Thomas*, 482 U.S. 483 (1987). In holding that a provision of the California Franchise Investment Law requiring judicial consideration of claims brought under the statute was preempted by the FAA, this Court in *Southland* declared that state law may limit the enforceability of agreements to arbitrate *only* upon " 'grounds as exist at law or in equity for the revocation of *any* contract.' " 465 U.S. at 11 (quoting 9 U.S.C. § 2) (emphasis added). Likewise, in *Perry*, this Court struck down a provision of the California Labor Code, which precluded arbitration of wage collection claims, on the ground that the California law did not "[arise] to govern issues concerning the validity, revocability, and enforceability of contracts generally," but rather "[took] its meaning precisely from the fact that a contract to arbitrate is at issue." 482 U.S. at 492 n. 9.

The Montana statute at issue here is preempted by the FAA because it clearly "takes its meaning precisely from the fact that a contract to arbitrate is at issue." Montana does not require that any other contractual provision be flagged with a conspicuous notice provision on the first page of the contract. Arbitration agreements alone are burdened with this requirement in Montana—burdened, in that the absence of such a notice renders the agreement to arbitrate unenforceable. Under this Court's decisions in *Southland* and *Perry*, therefore, the Montana statute is preempted by the FAA.

Indeed, in a recent pronouncement on the FAA, this Court reaffirmed that, under its holdings in *Southland* and *Perry*, the FAA preempts state laws that seek to invalidate arbitration agreements. *See Allied-Bruce Terminix Companies, Inc. v. Dobson*, 115 S. Ct. 834 (1995); *accord Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1215-16 (1995). In *Terminix*, this Court decisively rejected

a request to overrule *Southland* and permit state courts to apply their own anti-arbitration laws regardless of whether interstate commerce was involved, holding that *Southland* was well-established law and that, consequently, Alabama could not apply its statute barring pre-dispute arbitration agreements to invalidate an arbitration provision. *Terminix*, 115 S. Ct. at 838-39. After observing that the "basic purpose of the Federal Arbitration Act is to overcome courts' refusal to enforce agreements to arbitrate" and to place those agreements " 'upon the same footing as other contracts,' " *id.* at 838 (quoting *Volt*, 489 U.S. at 474), Justice Breyer, writing for this Court, concluded that while "States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause 'upon such grounds as exist at law or in equity for the revocation of *any* contract'[,] . . . [w]hat States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause," *Terminix*, 115 S. Ct. at 843 (quoting 9 U.S.C. § 2) (emphasis in original).

Montana has done precisely what this Court and numerous other federal and state courts over the past decade have held that it cannot do: It has decided that contracts are fair enough to enforce all their basic terms, even absent a special notice designed to bring the existence of those terms to the parties' attention, but that arbitration agreements are not fair enough to enforce without such a notice. Since this Court in *Terminix* made clear that state laws that place arbitration agreements "on an unequal footing" by definition undermine the goals and policies of the FAA, *Terminix*, 115 S. Ct. at 843, the Montana Supreme Court's refusal on remand to apply the principles reaffirmed in *Terminix* requires plenary review, if not summary reversal.

The Montana Supreme Court's holding also disregards the contrary decisions from the three federal courts of

appeals that have addressed the issue, all of which have invalidated arbitration notice provisions similar to the Montana statute. *See, e.g.*, *David L. Threlkeld & Co., Inc. v. Metallgesellschaft, Ltd. (London)*, 923 F.2d 245, 249-50 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991) (invalidating a Vermont statute that required agreements to arbitrate to be "prominently displayed" in contracts and signed by the parties); *Securities Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1120 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990) (invalidating a state regulation requiring full written disclosure of "the legal effect of the pre-dispute arbitration contract or clause"); *Webb v. R. Rowland & Co.*, 800 F.2d 803, 806-07 (8th Cir. 1986) (invalidating a requirement that contracts highlight the existence of arbitration clauses in 10-point capital letters); *Collins Radio Co. v. Ex-Cell-O Corp.*, 467 F.2d 995, 997-99 (8th Cir. 1972) (invalidating a requirement that arbitration agreements bear an attorney's acknowledgement that all parties have been advised of the agreement's effects). Instead, the Montana Supreme Court has joined a growing number of state courts that have reinvigorated the former hostility to arbitration by concluding that arbitration notice provisions do not run afoul of the FAA. *See, e.g.*, *American Physicians Service Group, Inc. v. Port Lavaca Clinic Assoc.*, 843 S.W.2d 675, 678 (Tex. Ct. App. 1992) (en banc), *writ of error denied* (Tex. Apr. 21, 1993); *Albright v. Edward D. Jones & Co.*, 571 N.E.2d 1329, 1332-33 (Ind. Ct. App. 1991), *cert. denied*, 113 S. Ct. 61 (1992). In addition, a number of states have similar laws that single out arbitration agreements for unfavorable treatment by regulating the placement and acknowledgment of arbitration agreements in certain types of contracts.[2] Courts in those states could well be encouraged by

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[2] *See* Petition for a Writ of Certiorari, at 23 nn. 20 & 21 (citing statutes).

the Montana Supreme Court's decision below to uphold similar anti-arbitration statutes against preemption attacks. Thus, there is a compelling need for this Court to review—and reverse—the decision of the Montana Supreme Court in order to signal to state courts and legislatures that, for purposes of preemption under the FAA, statutory notice provisions for arbitration are no less hostile to arbitration than were the statutes at issue in *Southland* and *Perry*.

B. The Montana Supreme Court's Decision Distorts This Court's Reasoning in *Volt*

In sustaining the Montana statute against a preemption attack, the Montana Supreme Court persists in its distortion of this Court's reasoning in *Volt* in several respects. First, the decision below completely disregards the parties' arbitration agreement. As this Court observed in *Volt*, the primary purpose of the FAA is to enforce "privately negotiated arbitration agreements," and parties to an arbitration agreement should be "at liberty to choose the terms under which they will arbitrate." 489 U.S. at 472. Here, the parties chose the AAA's Commercial Arbitration Rules and Connecticut law, not Montana law, to govern their arbitration agreement. Since neither Connecticut law nor the AAA's rules nor the FAA conditions the enforceability of an agreement to arbitrate on the existence of a notice provision, *Volt* cannot support the result reached by the Montana Supreme Court. On the contrary, the very notion of enforcing a notice provision *not* chosen by the parties to invalidate an arbitration provision *chosen* by the parties is completely antithetical to the teaching of *Volt* and strikes at the heart of the FAA's purpose—to ensure that private agreements to arbitrate are rigorously enforced according to their terms.

Second, the Montana Supreme Court's unduly narrow interpretation of the scope of federal preemption of state

arbitration laws is impossible to square with *Volt*. Purportedly relying on *Volt*, the Montana Supreme Court in its initial opinion declared that Montana's notice requirement does not "undermine the goals and policies of the FAA" because Congress never intended to preempt the entire field of arbitration and because the FAA does not require parties to arbitrate when they have not agreed to do so. App. B at 26a. The Montana Supreme Court reaffirmed that holding in its most recent opinion, finding that *Terminix* had not modified the preemption language in *Volt* on which the Montana Supreme Court had relied in its earlier opinion. However, this Court's statement in *Volt* that the FAA does not entirely preempt state arbitration law was made in reference to a California *procedural* statute that merely had the effect of delaying an arbitration until after litigation of related claims had occurred—and under circumstances where the parties had chosen that law to govern their arbitration. Thus, the California law affected only the timing of arbitration, and did not purport to prohibit arbitration altogether. Here, however, the Montana Supreme Court has interpreted *Volt* to permit a state to ban arbitration in its entirety, notwithstanding the existence of an arbitration agreement enforceable under the laws of the parties' own choosing.

Nor does the justification offered by the Montana Supreme Court for its holding—that the FAA mandates the enforcement only of those arbitration agreements that are "knowingly" entered into—survive scrutiny. Since the "knowing" requirement applies only to arbitration agreements and not to contracts generally in Montana, it is preempted under *Southland* and *Perry*. Behind Montana's preoccupation with ensuring that arbitration agreements are "knowingly" entered into lies considerable legislative and judicial hostility toward arbitration. Because the Montana Supreme Court's purported solicitude for arbitration may

encourage other state courts or legislatures to employ similar artifices to turn the FAA on its head, it is critical that this Court grant review of the decision below.

II.

THE MONTANA SUPREME COURT'S DECISION REPRESENTS UNSOUND PUBLIC POLICY

Arbitration notice provisions like Montana's not only run afoul of the Supremacy Clause and Section 2 of the FAA, but also represent unsound public policy based on discredited judicial and legislative hostility to arbitration. Opponents of arbitration have long maintained that arbitration represents an inferior, and inadequate, form of justice compared with traditional litigation because, they say, it deprives parties of, among other things, substantive rights under state statutory and common law, the right to a jury trial, wide-ranging discovery procedures, a broad right of appeal, competent adjudicators and, in many cases, an in-state forum. Detractors of arbitration also question the consensual nature of pre-dispute arbitration agreements, pointing out that those agreements are often contained in non-negotiated form contracts between parties of unequal bargaining power. These anti-arbitration sentiments, barely concealed in the initial majority opinion of the Montana Supreme Court, came to the surface in the special concurring opinion of Justice Trieweiler filed with the initial majority opinion. App. B at 28a-32a. Although the Montana Supreme Court has since attempted to distance itself from those sentiments as the basis for its holding, especially in light of the language in *Terminix* "extolling the virtues of arbitration," App. A at 7a (citing *Terminix*, 115 S. Ct. at 843), its continuing animosity to arbitration is apparent when it attributes this Court's recognition of the benefits of arbitration to partisan "input" from the AAA. App. A at 7a. There is little question that the Montana Supreme Court's

holding continues to be motivated by a distrust of arbitration and the benefits it affords.

This Court, however, has repeatedly dismissed as unfounded the various objections to arbitration noted above and,[3] in doing so, has acknowledged the many benefits of arbitration, including speed, *see, e.g.*, *Terminix*, 115 S. Ct. at 843; economy, *see, e.g.*, *id.*; informality and adaptability of procedures; *see, e.g.*, *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 633 (1985); availability of expert adjudicators, *see, e.g.*, *Mitsubishi*, 473 U.S. at 633; and ability to preserve the disputants' relationship, *see Terminix*, 115 S. Ct. at 843. Moreover, as this Court has observed, arbitration offers advantages to large and small businesses as well as to individuals, notwithstanding that it is often invoked under a form contract between parties having unequal bargaining power. *See Terminix*, 115 S. Ct. at 843; *Gilmer v. Interstate/Johnson Lane Corp.*, 111 S. Ct. 1647, 1655 (1991).

Permitting the decision below, with its inherent bias against arbitration, to stand will encourage other state courts and legislatures to likewise impair the enforceability of arbitration agreements, with serious repercussions for all business relationships that utilize arbitration to resolve disputes, but particularly for the franchise industry. Arbitra-

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[3] The various objections to arbitration which this Court has dismissed include: 1) its inability to further important social policies, *see Gilmer v. Interstate/Johnson Lane Corp.*, 111 S. Ct. 1647, 1653 (1991); 2) inherent bias of arbitrators, *see id.* at 1654; *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 634 (1985); 3) lack of discovery procedures, *see Gilmer*, 111 S. Ct. at 1654-55; 4) lack of meaningful judicial review, *see Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 232 (1987); incompetence of arbitrators, *see McMahon*, 482 U.S. at 232; 6) limitations on substantive rights or relief, *see Gilmer*, 111 S. Ct. at 1655; and 7) that it is the product of unequal bargaining power, *Gilmer*, 111 S. Ct. at 1655.

tion enjoys widespread use in the franchise community, in large part because it offers many advantages to franchisors and franchisees over traditional litigation. It is typically much less expensive than litigation because of the absence of, or limitations on, pleading requirements, motion practice, discovery and pretrial procedures. Since many disputes between franchisors and franchisees, such as claims for nonpayment of royalty fees, involve relatively small amounts of money, arbitration enables the parties to resolve these disputes economically without incurring legal expenses equivalent to the entire value of the claim. Moreover, the great majority of franchisors are relatively small companies and, like many franchisees, cannot afford the high cost associated with pursuing or defending claims in a judicial forum.

The elimination or reduction in scope of motion practice, discovery and pretrial procedures in arbitration also makes it generally much quicker than litigation. The relative speed with which arbitrations proceed from the initial filing of the arbitration demand to the issuance of an award and, if necessary, confirmation of the award by a court, not only will in most cases cost the parties less in attorneys' fees but also will enable them to resume their relationship more quickly without the continuing disruptive influence of a pending lawsuit. Similarly, the informality and often less adversarial nature of arbitration enhance the prospect that the franchisor and franchisee will be able to honor their contractual obligations while the arbitration is pending and put aside their differences once the arbitration has concluded, keeping their franchise relationship intact. Franchise relationships are unique in today's business world because they typically run for a period of ten to twenty years. Since disputes are more likely to arise in a relationship of that length, arbitration offers a method for resolving those disputes while preserving the long-term nature of the

relationship. Moreover, because arbitration is more flexible with regard to scheduling times and places of hearings, it tends to be less disruptive of the day-to-day operations of franchisors and franchisees alike, an important consideration in light of the fact that many franchisors and franchisees are small businesses with limited personnel. Finally, arbitration also offers the parties to a franchise relationship the option of having an individual experienced in franchising adjudicate their dispute. Because franchising is a unique form of business organization and is subject to a wide array of registration, disclosure and relationship laws, franchising expertise is often a sought-after qualification of arbitrators chosen to decide franchise disputes.

Moreover, there is nothing inherent in the arbitration process itself that favors franchisors over franchisees. Contrary to the anti-arbitration sentiments expressed in the initial special concurring opinion of Justice Trieweiler, App. B at 28a-32a, franchisees are often sophisticated, multi-unit operators who, on their own behalf or through counsel, negotiate the terms of their franchise agreements including whether and under what circumstances arbitration of disputes will occur. Although arbitration agreements often provide for arbitration in the franchisor's home state, there are sound business reasons for a franchisor to consolidate disputes with its franchisees in a forum where it can resolve them as cost-effectively as possible. It is certainly no more burdensome for an individual franchisee to arbitrate in the franchisor's home state than it is for a national franchisor to arbitrate against multiple franchisees in their respective home states. Indeed, in light of this Court's decision in *Carnival Cruise Lines, Inc. v. Shute*, 111 S. Ct. 1522 (1991), upholding the enforceability of a non-negotiated choice-of-forum clause printed on the reverse side of a cruise line passenger ticket, there is no serious argument that forum

selection clauses in the franchise relationship—a business relationship—are not fully enforceable.

Enforcement of arbitration agreements in the franchise relationship will also produce systemic benefits, economizing on the scarce judicial resources available for resolving other disputes where parties may not be in a position to structure a dispute resolution procedure in advance. Those scarce judicial resources are consumed not only when a dispute subject to arbitration is instead resolved in a judicial forum, but also when parties, encouraged by anti-arbitration decisions like those of the Montana Supreme Court in this case, initiate satellite litigation such as this to challenge the enforceability of agreements to arbitrate. Even if the franchisor ultimately succeeds on appeal in enforcing the agreement to arbitrate, significant judicial resources will often have been spent on both the trial and appellate level in reaching that result.

Unless the decision of the Montana Supreme Court is reversed, franchisors (and franchisees) as well as the judicial system as a whole will lose the many advantages of arbitration noted above. The decision of the Montana Supreme Court, if allowed to stand, will encourage state legislatures to enact a variety of requirements, restrictions and preconditions applicable to arbitration agreements. Although it may seem theoretically possible for a national franchisor to track such rules and adjust the arbitration provisions of its contracts to meet their requirements, in practice this would prove extremely burdensome and probably impossible. Once an agreement is signed it cannot be amended to comply with a subsequently enacted precondition to the enforceability of an arbitration agreement. Moreover, it is not clear under current law that such a legislative enactment would not be applied to a preexisting contract on the basis that it did not change substantive rights.

Furthermore, even if national franchisors undertook the burdensome task of tailoring their contract documents to meet the varying and often conflicting arbitration laws of 50 different states, they might still not be assured of having their arbitration agreements enforced, as this case itself demonstrates. A court—like the Montana Supreme Court in this case—may simply choose to disregard the parties' choice-of-law clause out of hostility toward arbitration and apply state notice requirement or other state anti-arbitration law that the parties never contemplated would be applied to their relationship. Since a nationwide franchisor cannot anticipate in what state it might be sued or what state's arbitration statute might apply, it has no effective means of assuring that it can partake of the benefits of arbitration that Congress sought to promote by enacting the FAA. Those benefits will be realized only if state courts and state legislatures are reminded that attempts to undermine the enforceability of agreements to arbitrate will not go unnoticed by this Court. Otherwise, state legislatures will be unleashed to formulate all manner of requirements for, and obstacles to, arbitration agreements, and the sound public policy that underlies the FAA will be subverted. For these reasons, it is critical to the franchising community that this Court review the decision of the Montana Supreme Court.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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(3)

No. 95-559

IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,
Petitioners,
v.
PAUL CASAROTTO, ET UX.,
Respondents.

On Writ of Certiorari to the Supreme Court of Montana

JOINT APPENDIX

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PETITION FOR CERTIORARI FILED OCTOBER 2, 1995
CERTIORARI GRANTED JANUARY 5, 1996

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MONTANA EIGHTH JUDICIAL DISTRICT COURT
CASCADE COUNTY

No. BDV-92-860

PAUL CASAROTTO and PAMELA CASAROTTO,
Plaintiffs,

v.

DANIEL L. HUDSON, *et al.*,
Defendants.

RELEVANT DOCKET ENTRIES

DATE	No.	PROCEEDINGS
9/14/92	1	Verified Complaint—Henry R. Crane, Tawney & Dayton—P.O. Box 3658, Missoula MT 59806 —See #49 Summons—Issued—
9/22/92	2	Summons Retd (9/18/92)
10/05/92	3	Stipulation (3 Defts)—Jack L. Lewis (Atty) —Jardine, Stephenson, Blewett & Weaver— Henry R. Crane—(Atty)—Tawney & Dayton —P.O. Box 3658—Missoula, MT. 59806—542-5000
10/06/92	4	Order (0/that Defts have until 11/2/92 within which to appear)
10/29/92	5	Fax copy of the Amended Verified Complaint
11/04/92	6	Amended Verified Complaint Summons—issd—(for Nick Lombardi & Doctor's Associates, Inc.)
11/09/92	7	Stip for Extension of time
11/09/92	8	Certificate of Mailing
11/10/92	9	Order (0/that Defts. Daniel L. & Deb Hudson & D&D Subway, have until 12/11/92 to respond to Pltfs' First Disc requests to Defts)

DATE	No.	PROCEEDINGS
11/12/92	10	Defts Daniel L. Hudson, Deb Hudson & D&D Subway Corp's mot for more definite statement & Memorandum in support
11/18/92	11	Stip for extension of time
11/18/92	12	Order (0/that Pltfs. Paul & Pamela Casarotto have until 12/21/92 to respond)
11/23/92	13	Response to Defts Mot for more definite statement & memorandum in sprt
12/08/92	14	Reply memo in supp of mot for more definite statement
12/31/92	15	Summons rtnd (12/8/92 Nick Lombarki)
1/06/93	16	Summons retd (Nick Lombardi (—))
1/06/93	17	Return of serv of summons & complaint by Doctor's Associates, Inc. (12/22/92)
1/29/93	18	Defts Doctor's Associates, Inc.'s & Nick Lombardi's mot to dismiss, or, in the alternative, to stay the proceedings pending arbitration L.D. Nybo (Atty)— Conklin, Nybo, Leveque & Murphy— Alan G. Schwartz & Isabel Chenoweth (Attys) Wiggin & Dana— One Century Tower—New Haven, CT 06508—
1/29/93	19	Memo of law in supp of defts' Doctor's Assoc. Inc., & Nick Lombardi's mot to dismiss, or, in the alternative, to stay the proceedings pending arbitration
2/12/93	20	Memo of law in opposition to defts' Doctor's Associates, Inc. & Nick Lombardi's motion to dismiss, or, in the alternative, to stay the proceedings pending arbitration
2/17/93	21	Motion for extension of time
2/17/93	22	Order (O/that defts Doctor's Assoc & Lombardi have until 2/26/93 which to file their reply)

DATE	No.	PROCEEDINGS
2/26/93	23	Reply memo of law in supp of defts' Doctors Associates, Inc. & Nick Lombardi's mot to dismiss, or in the alternative, to stay pending arbitration
3/05/93	24	Application for hearing (Pltf's)
3/05/93	25	Mot for special admission of out-of-state counsel
4/01/93	26	Order (Hrg set for 5/26/93 @ 10:00 A.M.)
4/21/93	27	Application for Hrg
5/25/93		Subp. Duces Tecum—Issued—Deft Hudson 1 —Norwest Bank
5/26/93		Hrg Re: Mot to dismiss: Crt (McCarvel) rules in favor of defts, Drs. Associates & Nick Lombardi and stays the proceedings until arbitration is completed. (Heiman)
5/26/93	28	Stip for protective order
6/01/93	29	Protective order (see order for details)
6/02/93	30	Order (ordered and adjudged that pltfs' claims against the defts Doctor's Associates, Inc., and Nick Lombardi are hereby stayed until the arbitration has been had in accordance with the terms of the arbitration agreement)
6/14/93	31	Motion for reconsideration or to partially lift stay
6/14/93	32	Memo of law in supp of pltfs' mot for reconsideration or to alter/amend order
6/24/93	33	Memo of law of defts Doctor's Associates, Inc. and Nick Lombardi in opposition to pltfs' mot for reconsideration or to alter/amend order
7/02/93	34	Notice of Appeal
7/07/93	35	Mot & brief for entry of rule 54(B) order certifying this court's June 2, 1993 order appealable to the Montana Supreme Court

DATE	No.	PROCEEDINGS
7/08/93	36	Rule 54(B) order (O/that court certifies that the 6/2/93 order is a final judgment pursuant to rule 54(B) as to the following issues: see order)
8/13/93	37	Mot for extention of time to transmit record and brief in supp thereof
8/16/93	38	Order extending time to transmit record (O/ that ptlfs are granted to 9/30/93 to transmit the record on appeal herein)
8/18/93	39	Answer to amended verified complaint. Counterclaims and set-off (Daniel L. and Deb Hudson and D&D Subway Corp)
8/24/93	40	Stip to withdraw mot for more definite statement and application for Hrg
8/24/93	41	Order (O/that mot of defts Daniel L. and Deb Hudson & D&D Subway Corp for a more definite statement is withdrawn . . .)
8/26/93	42	Reply to counterclaim & set off
8/26/93	43	Certificate of service
9/02/93		Subp. duces tecum—ISS—(Nick Lombardi)
9/03/93	44	Certificate of service
9/28/93		—File transmitted to Supreme Court by cert mail # P 674 330 301—
10/07/93	45	Sub/duc/tec retd (1-pltf) (Nick Lombardi)
10/18/93	46	Mot for protective order & sprting brief of deft Lombardi
10/26/93	47	Cert of mailing
10/27/93	48	Stip re: deft Lombardi's mot for protective order
2/22/94	49	Notice of change of address—Grant D. Parker (atty for pltf)—Mullendore, Tawney & Watt

DATE	No.	PROCEEDINGS
		—310 West Spruce, Missoula 59802—542-5000 —and Peter Michael Meloy (atty)—Meloy Law Firm—Box 1244, Helena 59601—442-2442—
1/10/95	50	Remittitur & opinion from the Supreme Court (judgment is reversed and remanded)—No final jdgmt yet—called NYBO and he said there is no final jdgmt yet—
1/12/95	51	Receipt of remittitur
1/24/95	52	Supreme Court appeal checklist
3/21/95	53	Request for statement of claim (defts)
3/30/95	54	Response to request for statement of claim (pltfs)
9/20/95	55	Remittitur & opinion from the Supreme Court (on remand and reconsideration. It is now here ordered and adjudged that this court's opinion issd Dec. 15, 1994 is reaffirmed & reinstated)

IN THE SUPREME COURT
OF THE STATE OF MONTANA

No. 93-488

PAUL CASAROTTO and PAMELA CASAROTTO,
Plaintiffs and Appellants,

vs

DANIEL L. and DEB HUDSON,
D&D SUBWAY CORPORATION, NICK LOMBARDI,
and DOCTOR'S ASSOCIATES, INC.,
Defendants and Respondents.

RELEVANT DOCKET ENTRIES

DATE	PROCEEDINGS
09/29/93	District Court record filed. (2 manilla folders; orig. & two copies of Transcript.
10/26/93	Order granting appellant until Nov. 26, 1993, to file brief.
11/26/93	Appellant's brief filed. (returned for addendum)
12/02/93	Appellant's brief received back.
12/17/93	Order granting respondents until Jan. 14, 1994, to file brief.
12/23/93	Motion for Admission of Out-of-State Counsel. Sent to Court.
12/23/93	ORDER: That attorneys Ian E. Bjorkman and Alan G. Schwartz be and are hereby admitted to practice before the Supreme Court of the State of Montana, for purposes of this case only, as co-counsel, representing the defendants-respondents Doctor's Associates, Inc., and Nick Lombardi.

DATE	PROCEEDINGS
01/14/94	Respondent's brief, with separate Appendix, filed. (Nick Lombardi and Doctor's Associates, Inc.)
01/25/94	Order granting appellant until Feb. 8, 1994, to file reply brief.
02/08/94	Reply brief filed.
02/09/94	SENT TO COURT.
02/17/94	Order; Classified for submission for oral argument before the Court sitting en banc. That counsel for all parties in this appeal are hereby directed to specifically address in oral argument the issue of preemption in the following United States Supreme Court case: *Volt Information Sciences, Inc. vs. Board of Trustees of the Leland Stanford Junior University* (1989), 489 U.S. 468, 103 L.Ed.2d 488, 109 S.Ct. 1248. The Court will consider receiving amicus curiae briefs relative to this cause.
02/22/94	Notice of change of address. (Parker, Mullendore, Tawney & Watt)
03/04/94	Oral argument set for April 15, 1994 at 10:30 am. (Held at U. of M. Law School).
03/11/94	Order granting the Montana Trial Lawyers Assoc. leave to file an Amicus Curiae Brief. The brief shall be filed no later than the 8th day of April, 1994. (no env.)
03/15/94	Letter from President of Montana Defense Trial Lawyers, Inc. (will not seek leave to file an amicus brief)
03/16/94	Order that Doctor's Assoc. and Lombardi are hereby permitted to file a reply brief by March 28, 1994.
03/28/94	Reply brief filed. COPIES TO COURT.

DATE	PROCEEDINGS
03/28/94	Order granting appellants until April 8, 1994, to file a brief, not to exceed 10 pages, addressing the applicability of *Volt Info. Services v. Leland Stanford Junior University.*
04/01/94	Motion of Amici Curiae International Franchise Assoc. Securities Industry Assoc. copies to Court.
04/05/94	Order; the motion of amici curiae for leave to file an amici curiae brief is granted, and the clerk is directed to file the amici brief submitted with the motion for leave to file. Amicus brief filed. (International Franchise Assoc. & Snap-On)
04/08/94	Reply brief filed. SENT TO COURT.
04/08/94	Amicus Curiae Brief of Montana Trial Lawyers Assoc. Copies to Court.
04/15/94	Oral argument presented. Grant D. Parker argued for the appellant and Alan G. Schwartz argued for the respondent. Taken under advisement at 11:53 a.m.
08/02/94	Motion for leave to file notice of supplemental authority.
08/16/94	Order; that appellants' motion for leave to file supplemental authority is GRANTED.
12/15/95	Opinion; Justice Trieweiler; reversed and remanded; Harrison; Hunt and Nelson concur. Justice Trieweiler specially concurs; Justice Weber dissents. Chief Justice Turnage dissents. Justice Gray dissents.
01/03/95	Remittitur issued. District court record returned.
CLOSED	
06/14/95	US Supreme Court Writ of Certiorari is granted. Judgment vacated and case remanded to MT Supreme Court for consideration in light of Terminix v. Dobson, 513 U.S. (1995).

DATE	PROCEEDINGS
07/17/95	US Supreme Court order granting the petition for writ of certiorari; certified copy of the mandate of the Court and copy of the opinion cited in the judgment filed. Sent to Court.
08/31/95	OPINION: Trieweiler; Reaffirmed and reinstated December 15, 1994 opinion; Nelson, Hunt, Leaphart, concur; Leaphart specially concurs, Gray dissented with Turnage and Weber joining in dissent.
09/19/95	Remittitur issued. (No district court record to return)
CLOSED	

[Filed Jun. 2, 1993]

MONTANA EIGHTH JUDICIAL DISTRICT COURT
CASCADE COUNTY

No. BDV-92-860

PAUL CASAROTTO and PAMELA CASAROTTO,
Plaintiffs,

vs.

DANIEL L. and DEB HUDSON,
D&D SUBWAY CORPORATION, NICK LOMBARDI,
and DOCTOR'S ASSOCIATES, INC.,
Defendants.

ORDER

This cause is before the Court on the defendants Doctor's Associates, Inc. ("DAI") and Nick Lombardi's motion to dismiss, or in the alternative, to stay pending arbitration. The Court having considered the briefs, the argument of counsel and the evidence submitted, rules as follows:

1. The plaintiff Paul Casarotto (the "franchisee") and DAI entered into a franchise agreement dated April 25, 1988 that concerned interstate commerce. DAI is the national franchisor of "Subway" sandwich shops and the franchise agreement permits, *inter alia*, the franchisee a license to use the nationally-known and federally-registered "Subway" trademark.

2. The franchise agreement contained a clause requiring that:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial

> Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost of such a proceeding will be borne equally by the parties.

3. The claims asserted by the plaintiffs against defendants DAI and its alleged agent Lombardi arise out of and relate to the franchise agreement and are therefore encompassed by the arbitration clause and referable to arbitration.

4. The Federal Arbitration Act requires that if an action is brought upon any issue referable to arbitration under the terms of an arbitration agreement, the suit shall be stayed "until such arbitration has been had in accordance with the terms of the agreement. . . ." 9 U.S.C. § 3. *See also, e.g., Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24-25 (1983); *Downey v. Christensen*, 825 P.2d 557, 559 (Mont. 1992).

5. DAI has demanded arbitration of the plaintiffs' claims under the rules of the American Arbitration Association.

Accordingly, it is ordered and adjudged that plaintiffs' claims against the defendants Doctor's Associates, Inc., and Nick Lombardi are hereby stayed until the arbitration has been had in accordance with the terms of the arbitration agreement.

DONE and ORDERED this 2nd day of June, 1993.

/s/ John M. McCarvel
District Judge

[Filed Dec. 15, 1994]

IN THE SUPREME COURT
OF THE STATE OF MONTANA
1994

No. 93-488

PAUL CASAROTTO and PAMELA CASAROTTO,
Plaintiffs and Appellants,

v.

NICK LOMBARDI and DOCTOR'S ASSOCIATES, INC.,
Defendants and Respondents,

and

DANIEL L. and DEB HUDSON, and
D&D SUBWAY CORPORATION,
Defendants.

Appeal from District Court of the Eighth Judicial District,
In and for the County of Cascade,
The Honorable John M. McCarvel, Judge presiding

Submitted: April 19, 1994

Decided: December 15, 1994

Justice Terry N. Trieweiler delivered the opinion of the Court.

Plaintiffs Paul and Pamela Casarotto filed this suit in the District Court for the Eighth Judicial District in

Cascade County to recover damages which they claim were caused by the defendants' breach of contract and tortious conduct. Defendants Nick Lombardi and Doctor's Associates, Inc. (DAI), moved the District Court for an order dismissing plaintiffs' complaint, or in the alternative, staying further judicial proceedings pending arbitration of plaintiffs' claims pursuant to a provision in DAI's franchise agreement with plaintiffs which required that disputes "arising out of or relating to" that contract be settled by arbitration. The District Court granted defendants' motion, and ordered that further judicial proceedings be stayed until arbitration proceedings were completed in accordance with the terms of the parties' agreement. Plaintiffs appeal from that order. We reverse the order of the District Court.

The issues raised on appeal are:

1. Based on conflict of law principles, is the franchise agreement entered into between the Casarottos and DAI governed by Connecticut law or Montana law?

2. If the contract is governed by Montana law, is the notice requirement in § 27-5-114(4), MCA, of Montana's Uniform Arbitration Act, preempted by the Federal Arbitration Act found at 9 U.S.C. §§ 1-15 (1988)?

FACTUAL BACKGROUND

On October 29, 1992, Paul and Pamela Casarotto filed an amended complaint naming Doctor's Associates, Inc., and Nick Lombardi as defendants. For purposes of our review of the District Court's order, we presume the facts alleged in the complaint to be true.

DAI is a Connecticut corporation which owns Subway Sandwich Shop franchises, and Lombardi is their development agent in Montana. The Casarottos entered into a franchise agreement with DAI which allowed them to open a Subway Sandwich Shop in Great Falls, Montana.

However, they were told by Lombardi that their first choice for a location in Great Falls was unavailable.

According to their complaint, the Casarottos agreed to open a shop at a less desirable location, based on a verbal agreement with Lombardi that when their preferred location became available, they would have the exclusive right to open a store at that location. Contrary to that agreement, the preferred location was subsequently awarded by Lombardi and DAI to another franchisee. As a result, the Casarottos' business suffered irreparably, and they lost their business, along with the collateral which secured their SBA loan.

This action is based on the Casarottos' allegation that Lombardi and DAI breached their agreement with the Casarottos, defrauded them, breached the covenant of good faith and fair dealing, and engaged in other tortious conduct, all of which directly caused the Casarottos loss of business and the resulting damage.

DAI's franchise agreement with the Casarottos was executed on April 25, 1988. There was no indication on the first page of the contract that it was subject to arbitration. However, paragraph 10(c) of the contract, found on page 9, included the following provision:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost of such a proceeding will be born equally by the parties.

On January 29, 1993, DAI moved the District Court to dismiss the Casarottos' complaint, or at least stay further judicial proceedings, pending arbitration pursuant to paragraph 10(c) of the franchise agreement. DAI alleged that the franchise agreement affected interstate commerce, and therefore, was subject to the Federal Arbitration Act found at 9 U.S.C. §§ 1-15 (1988). They sought a stay of proceedings pursuant to § 3 of that Act, which provides in relevant part that:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement . . . .

DAI claimed that Montana law could not be raised as a bar to enforcement of the arbitration provision for two reasons: First, the contract specifically called for the application of Connecticut law; and second, Montana law was preempted by the Federal Arbitration Act.

The Casarottos opposed DAI's motion on the grounds that Montana law applied, in spite of the choice of law provision in the contract, and that based on § 27-5-114 (4), MCA, the contract's arbitration provision was unenforceable because DAI had not provided notice on the first page of the agreement that the contract was subject to arbitration.

On June 2, 1993, the District Court issued its order granting DAI's motion to stay further judicial proceedings pursuant to 9 U.S.C. § 3. The order was made applicable to both DAI and Lombardi, but not to other named defendants who were not parties to the franchise agreement and whose alleged conduct raises other issues.

On July 8, 1993, the District Court issued an order pursuant to Rule 54(b), M.R.Civ.P., certifying its June 2 order as final for purposes of appeal. The Casarottos appeal from that order.

ISSUE 1

Based on conflict of law principles, is the franchise agreement entered into between the Casarottos and DAI governed by Connecticut law or Montana law?

Paragraph 12 of the franchise agreement entered into between the parties provides as follows: "This agreement shall be governed by and construed in accordance with the laws of the State of Connecticut and contains the entire understanding of the parties." DAI contends that, therefore, Connecticut law governs our interpretation of the contract and that since Connecticut law is identical to the Federal Arbitration Act *see* Conn. Gen. Stat. § 52-409 (1993), conspicuous notice that the contract was subject to arbitration was not required and we need not concern ourselves with the issue of whether Montana law is preempted.

The Casarottos respond that the issue of whether to apply Connecticut or Montana law involves a conflict of law issue and that the answer can be found in our prior decisions. We agree.

In *Emerson v. Boyd* (1991), 247 Mont. 241, 805 P.2d 587, we cited with approval the Ninth Circuit's decision in *R.J. Williams Co. v. Fort Belknap Housing Authority* (9th Cir. 1983), 719 F.2d 979, which adopted the criteria established in Restatement (Second) of Conflict of Laws § 188 (1971) to determine which jurisdiction's laws apply to a contract where no choice of law is provided for in the contract. Section 188 provides as follows:

> (1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in § 6.

> (2) In the absence of an effective choice of law by the parties (see § 187), the context to be taken into account in applying the principles of § 6 to determine the law applicable to an issue include:
>
> (a) the place of contracting,
>
> (b) the place of negotiation of the contract,
>
> (c) the place of performance,
>
> (d) the location of the subject matter of the contract, and
>
> (e) the domicil, residence, nationality, place of incorporation and place of business of the parties.
>
> These contracts are to be evaluated according to their relative importance with respect to the particular issue.
>
> (3) If the place of negotiating the contract and the place of performance are in the same state, the local law of this state will usually be applied, except as otherwise provided in §§ 189-199 and 203.

In this case, there is a choice of law provision in the parties' contract. The question is whether it was an "effective" choice. We recently held in *Youngblood v. American States Ins. Co.* (1993), 262 Mont. 391, 394, 866 P.2d 203, 205, that this State's public policy will ultimately determine whether choice of law provisions in contracts are "effective." In that case, we stated:

> Here, the general policy language in the insurance contract requires American States to pay whatever damages are required in Montana; that is, the contract is to be performed in Montana. Therefore, unless a contract term provides otherwise, *Kemp* [*v. Allstate Ins. Co. (1979), 183 Mont. 526, 601 P.2d 20*] and § 28-3-102, MCA, require the application of Montana law because the contract was to be 'per-

formed' in Montana. In this case, however, the insurance contract contains a choice of law provision which requires the application of Oregon subrogation law. . . .

. . . .

. . . [T]he choice of law provision will be enforced unless enforcement of the contract provision requiring application of Oregon law as regards subrogation of medical payments violates Montana's public policy or is against good morals.

Youngblood, 866 P.2d at 205.

Based on our conclusion in that case that subrogation of medical payment benefits was contrary to our public policy, we held that:

> [T]he choice of law provision in the insurance contract would result in medical payment subrogation under Oregon law. Because such subrogation violates Montana's public policy, that term of the insurance contract at issue here is not enforceable.

Youngblood, 866 P.2d at 208.

Restatement (Second) of Conflict of Laws § 187(2) (1971) is consistent with our decision in *Youngblood*, and expands upon the factors to be considered under the circumstances in this case. It provides that:

> (2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either
>
> (a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or

> (b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

Adopting § 187, then, as our guide, we first look to § 188 to determine whether Montana law would be applicable absent an "effective" choice of law by the parties.

According to the affidavit of Paul Casarotto filed in opposition to DAI's motion to dismiss, he executed the contract in neither Connecticut nor Montana. It was executed while he was traveling in New York. However, it appears from that same affidavit, and from the allegations in the complaint, that original negotiations were conducted by him in Great Falls, the contract was to be performed in Great Falls, the subject matter of the contract (the Subway Sandwich Shop) was located in Great Falls, and that he and Pamela Casarotto resided in Great Falls at the time that the contract was executed. The only connection to Connecticut was that DAI was incorporated in that state and apparently had its home office in that state at the time of the parties' agreement. We conclude that based upon the application of the criteria set forth in § 188, and our prior decision in *Emerson*, Montana has a materially greater interest than Connecticut in the contract issue that is presented, and that absent an "effective" choice of law by the parties, Montana law would apply.

Our remaining inquiry, then, is whether application of Connecticut law would be contrary to a fundamental policy of this State by eliminating the requirement that notice be provided when a contract is subject to arbitration.

In *Trammel v. Brotherhood of Locomotive Firemen and Enginemen* (1953), 126 Mont. 400, 409, 253 P.2d 329, 334, we held that the public policy of a state is established by its express legislative enactments. Here, the legislative history for § 27-5-114(4), MCA, makes clear that the legislative committee members considering adoption of the Uniform Arbitration Act had two primary concerns. First, they did not want Montanans to waive their constitutional right of access to Montana's courts unknowingly, and second, they were concerned about Montanans being compelled to arbitrate disputes at distant locations beyond the borders of our State.

The facts in this case, and our recent decision in another case, justify those concerns.

Regardless of the amount in controversy between these parties, the arbitration clause in the Subway Sandwich Shop Franchise Agreement requires that the Casarottos travel thousands of miles to Connecticut to have their dispute arbitrated. Furthermore, it requires that they share equally in the expense of arbitration, regardless of the merits of their claim. Presumably, that expense could be substantial, since under the Commercial Arbitration Rules of the American Arbitration Association (1992), those expenses would, at a minimum, include: the arbitrator's fees and travel expenses, the cost of witnesses chosen by the arbitrator, the American Arbitration Association's administrative charges, and a filing fee of up to $4000, depending on the amount in controversy. For a proceeding involving multiple arbitrators, the administrative fee alone, for which the Casarottos would be responsible, is $150 a day. In addition, since the contract called for the application of Connecticut law, the Casarottos would be required to retain the services of a Connecticut attorney.

In spite of the expense set forth above, the procedural safeguards which have been established in Montana to assure the reliability of the outcome in dispute resolutions

are absent in an arbitration proceeding. The extent of pretrial discovery is within the sole discretion of the arbitrator and the rules of evidence are not applicable. The arbitrator does not have to follow any law, and there does not have to be a factual basis for the arbitrator's decision. *See May v. First National Pawn Brokers, Ltd.* (Mont. Dec. 15, 1994), Slip Op. 94-189.

Based upon the determination by the Legislature of this State that the citizens of this State are at least entitled to notice before entering into an agreement which will limit their future resolution of disputes to a procedure as potentially inconvenient, expensive, and devoid of procedural safeguards as the one provided for by the rules of the American Arbitration Association, and the terms of this contract, we conclude that the notice requirement of § 27-5-114, MCA, does establish a fundamental public policy in Montana, and that the application of Connecticut law would be contrary to that policy. Therefore, we conclude that the law of Montana governs the franchise agreement entered into between the Casarottos and Doctor's Associates, Inc.

ISSUE 2

If the contract is governed by Montana law, is the notice requirement in § 27-5-114(4), MCA, of Montana's Uniform Arbitration Act, preempted by the Federal Arbitration Act found at 9 U.S.C. §§ 1-15 (1988)?

DAI contends that even if Montana law is applicable, § 27-5-114(4), MCA, is preempted by the Federal Arbitration Act because it would void an otherwise enforceable arbitration agreement. In support of its argument, DAI relies on U.S. Supreme Court decisions in *Perry v. Thomas* (1987), 482 U.S. 483, 107 S. Ct. 2520, 96 L. Ed. 2d 426, *Southland Corp. v. Keating* (1984), 465 U.S. 1, 104 S. Ct. 852, 79 L. Ed. 2d 1, and *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*

(1983), 460 U.S. 1, 103 S. Ct. 927, 74 L. Ed. 2d 765. These cases have been referred to as "[a] trilogy of United States Supreme Court cases" which "developed the federal policy favoring arbitration and the principle that the FAA is substantive law enacted pursuant to Congress's commerce powers that preempts contrary state provisions." David P. Pierce, *The Federal Arbitration Act: Conflicting Interpretations of its Scope* 61 Cinn. L. Rev. 623, 630 (1992). From this trilogy, *Southland* and *Perry* appear to be closest on point and warrant some discussion.

Southland Corporation was the owner and franchisor of 7-Eleven Convenience Stores. Its standard franchise agreements, like DAI's included an arbitration provision. Southland was sued in California by several of its franchisees, based on claims which included violations of the disclosure requirements of the California Franchise Investment Law, Cal. Corp. Code § 31000, *et seq.* (West 1977). The California Supreme Court held that the Franchise Investment Law required judicial consideraiton of claims brought under that statute, and therefore, held that arbitration could not be compelled. The U.S. Supreme Court disagreed, and held that:

> In creating a substantive rule applicable in state as well federal courts, Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements. We hold that § 31512 of the California Franchise Investment Law violates the Supremacy Clause.

Southland, 465 U.S. at 16 (footnotes omitted).

In *Perry,* the Supreme Court was called upon to reconcile 9 U.S.C. § 2 which mandates enforcement of arbitration agreements, with § 229 of the California Labor Code, "which provides that actions for the collection of wages may be maintained 'without regard to the existence of any private agreement to arbitrate.'" *Perry,* 465 U.S. at 484 (quoting Cal. Lab. Code § 229 (West 1971)).

In that case, Kenneth Thomas sued his former employer for commissions he claimed were due for the sale of securities. His employer sought to stay the proceedings pursuant to §§ 2 and 4 of the Federal Arbitration Act, based on the arbitration provision found in Thomas's application for employment. *Perry,* 465 U.S. at 484-85. In an opinion affirmed by the California Court of Appeals and the California Supreme Court, the California Superior Court denied the motion to compel arbitration. On appeal, the U.S. Supreme Court held that § 2 of the FAA reflected a strong national policy favoring arbitration agreements, notwithstanding "state substantive or procedural policies to the contrary." *Perry,* 482 U.S. at 489. Citing its decision in *Southland,* the Court held that:

> "Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements." Id. at 16 (footnote omitted). Section 2, therefore, embodies a clear federal policy of requiring arbitration unless the agreement to arbitrate is not part of a contract evidencing interstate commerce or is revocable "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. "We see nothing in the Act indicating that the broad principle of enforceability is subject to any additional limitations under state law." *Keating, supra,* at 11.

Perry, 482 U.S. at 489-90.

As additional authority, DAI cites to our own previous decisions which have enforced arbitration agreements in Montana based on *Southland* and *Perry. See Downey v. Christensen* (1992), 251 Mont. 386, 825 P.2d 557; *Vukasin v. D.A. Davidson & Co.* (1990), 241 Mont. 126, 785 P.2d 713; *William Gibson, Jr., Inc. v. James Graff Communications* (1989), 239 Mont. 335, 780 P.2d 1131; *Larsen v. Opie* (1989), 237 Mont. 108, 771 P.2d 977; *Passage v. Prudential-Bache Securities, Inc.* (1986), 223 Mont. 60, 727 P.2d 1298.

The Casarottos, however, contend that *Southland* and *Perry* must be considered in light of the Supreme Court's more recent decision in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University* (1989), 489 U.S. 468, 109 S.Ct. 1248, 103 L.Ed.2d 488, and that our prior arbitration decisions did not deal with the enforceability of arbitration agreements which violated Montana's statutory law. We agree.

In *Volt*, the parties entered into a construction contract which contained an agreement to arbitrate all disputes between the parties relating to the contract. The contract also provided that it would be governed by the law in the state where the project was located. *Volt*, 489 U.S. at 470.

As a result of a contract dispute between the parties, Stanford filed an action in California Superior Court naming Volt and two other companies involved in the construction project. Volt petitioned the Superior Court to compel arbitration of the dispute. However, the California Arbitration Act found at Cal. Civ. Proc. Code § 1280, *et seq.* (West 1982), contained a provision allowing the court to stay arbitration pending resolution of related litigation. On that basis, the Superior Court denied Volt's motion to compel arbitration, and instead, stayed arbitration proceedings pending outcome of the litigation. The California Court of Appeals affirmed that decision, and the California Supreme Court denied Volt's petition for discretionary review. The U.S. Supreme Court granted review and affirmed the decision of the California courts. *Volt*, 489 U.S. at 471-73.

On appeal, the Supreme Court considered Volt's argument that California's arbitration laws were preempted by the Federal Arbitration Act. In its analysis of the preemption issue, the Supreme Court stated that:

> The FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration. But even when

> Congress has not completely displaced state regulation in an area, state law may nonetheless be preempted to the extent that it actually conflicts with federal law—that is, to the extent that it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). *The question before us, therefore, is whether application of Cal.Civ.Proc. Code Ann. § 1281.2(c) to stay arbitration under this contract in interstate commerce, in accordance with the terms of the arbitration agreement itself, would undermine the goals and policies of the FAA. We conclude that it would not.*

Volt, 489 U.S. at 477-78 (citation omitted; emphasis added).

The Supreme Court explained that the purpose of the Federal Arbitration Act was to enforce lawful agreements entered into by the parties, and not to impose arbitration on the parties involuntarily. It noted that in this case the parties' agreement was to be bound by the arbitration rules from California. Therefore, it held that:

> Where, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA, even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward. By permitting the courts to "rigorously enforce" such agreements according to their terms, see [*Dean Witter Reynolds, Inc. v.*]*Byrd*, [470 U.S.] at 221, we give effect to the contractual rights and expectations of the parties, without doing violence to the policies behind the FAA.

Volt, 489 U.S. at 479.

While the Court in *Volt* applied state laws that had been chosen by the parties in their contract, and this case

involves state law which is applied pursuant to conflict of law principles, it has been observed that:

> The real significance of the *Volt* decision is not in the Court's holding, but rather in what the Court failed to hold. For example, the Court found no preemption of the California arbitration law by the FAA. Instead, the Court merely stated that Congress did not intend that the FAA occupy the entire field of arbitration law. Thus, enforcing the California law was merely a procedural issue and did not frustrate the policy behind the FAA of enforcing the agreement.

David P. Pierce, *The Federal Arbitration Act: Conflicting Interpretations of its Scope* 61 Cinn. L. Rev. 623, 635 (1992) (footnotes omitted).

Section 2 of 9 U.S.C. provides that:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transactions, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*

(Emphasis added.)

Based upon the Supreme Court's decision in *Volt,* we conclude that the nature of our inquiry is whether Montana's notice requirement found at § 27-5-114(4), MCA, would "undermine the goals and policies of the FAA." We conclude that it does not.

DAI relies on decisions in *Threlkeld & Co., Inc. v. Metallgesellschaft Ltd.* (2d Cir. 1991), 923 F.2d 245,

Securities Industry Ass'n v. Connolly (1st Cir. 1989), 883 F.2d 1114, *Webb v. R. Rowland & Co., Inc.* (8th Cir. 1986), 800 F.2d 803, and *Bunge Corp. v. Perryville Feed & Produce, Inc.* (Mo. 1985), 685 S.W.2d 837, in support of its argument that notice provisions are preempted by federal law.

The Casarottos, on the other hand, rely on decisions in *American Physicians v. Port Lavaca Clinic* (Tex. Ct. App. 1992), 843 S.W.2d 675, and *Albright v. Edward D. Jones & Co.* (Ind. Ct. App. 1991), 571 N.E.2d 1329, for the principle that since *Volt,* other courts have held that notice provisions in state arbitration laws are not preempted by the Federal Arbitration Act.

However, the cases cited by the parties either precede the Supreme Court's decision in *Volt,* or contain little or no reference to the *Volt* decision. We conclude that none are persuasive, and we must rely on our own analysis of whether Montana's notice requirement undermines the goals and policies of the FAA.

Our conclusion that Montana's notice requirement does not undermine the policies of the FAA is based on the Supreme Court's conclusion that it was never Congress's intent when it enacted the FAA to preempt the entire field of arbitration, and its further conclusion that the FAA does not require parties to arbitrate when they have not agreed to do so. That Court held that the purpose of the FAA is simply to enforce arbitration agreements into which parties had entered, and acknowledged that the interpretation of contracts is ordinarily a question of state law. *Volt,* 489 U.S. at 474.

Presumably, therefore, the Supreme Court would not find it a threat to the policies of the Federal Arbitration Act for a state to require that before arbitration agreements are enforceable, they be entered knowingly. To hold otherwise would be to infer that arbitration is so

onerous as a means of dispute resolution that it can only be foisted upon the uninformed. That would be inconsistent with the conclusion that the parties to the contract are free to decide how their disputes should be resolved.

Montana's notice requirement does not preclude parties from knowingly entering into arbitration agreements, nor do our courts decline to enforce arbitration agreements which are entered into knowingly.

Therefore, we conclude that Montana's notice statute found at § 27-5-114(4), MCA, would not undermine the goals and policies of the FAA, and is not preempted by 9 U.S.C. § 2 (1988).

Because the agreement of the parties in this case did not comply with Montana's statutory notice requirement, it is not subject to arbitration, according to the law of Montana. The District Court's order dated June 2, 1993, is, therefore, reversed, and this case is remanded to the District Court for further proceedings consistent with this opinion.

/s/ Terry Trieweiler
Justice

We concur:

/s/ John Conway Harrison

/s/ William E. Hunt, Sr.

/s/ James C. Nelson
Justices

Justice Terry N. Trieweiler specially concurring.

The majority opinion sets forth principles of law agreeable to the majority of this Court in language appropriate for judicial precedent. I offer this special concurring opinion as my personal observation regarding many of the federal decisions which have been cited to us as authority.

To those federal judges who consider forced arbitration as the panacea for their "heavy case loads" and who consider the reluctance of state courts to buy into the arbitration program as a sign of intellectual inadequacy, I would like to explain a few things.

In Montana, we are reasonably civilized and have a sophisticated system of justice which has evolved over time and which we continue to develop for the primary purpose of assuring fairness to those people who are subject to its authority.

Over the previous 100 years of our history as a state, our courts have developed rules of evidence for the purpose of assuring that disputes are resolved on the most reliable bases possible.

Based on the presumption that all men and women are fallible and make mistakes, we have developed standards for appellate review which protect litigants from human error or the potential arbitrariness of any one individual.

We believe in the rule of law so that people can plan their commercial and personal affairs. If our trial courts decline to follow those laws, our citizens are assured that this Court will enforce them.

We have rules for venue, and jurisdictional requirements based on the assumption that it is unfair to force people to travel long distances from their homes at great expense and inconvenience to prosecute or defend against lawsuits.

We believe that our courts should be accessible to all, regardless of their economic status, or their social importance, and therefore, provide courts at public expense and guarantee access to everyone.

We have developed liberal rules of discovery (patterned after the federal courts) based on the assumption that the open and candid exchange of information is the surest way to resolve claims on their merits and avoid unnecessary trials.

We have contract laws and tort laws. We have laws to protect our citizens from bad faith, fraud, unfair business practices, and oppression by the many large national corporations who control many aspects of their lives but with whom they have no bargaining power.

While our system of justice and our rules are imperfect, they have as their ultimate purpose one overriding principle. They are intended, and continue to evolve, for the purpose of providing fairness to people, regardless of their wealth or political influence.

What I would like the people in the federal judiciary, especially at the appellate level, to understand is that due to their misinterpretation of congressional intent when it enacted the Federal Arbitration Act, and due to their naive assumption that arbitration provisions and choice of law provisions are knowingly bargained for, all of these procedural safeguards and substantive laws are easily avoided by any party with enough leverage to stick a choice of law and an arbitration provision in its preprinted contract and require the party with inferior bargaining power to sign it.

The procedures we have established, and the laws we have enacted, are either inapplicable or unenforceable in the process we refer to as arbitration.

I am particularly offended by the attitude of federal judges, typified by the remarks of Judge Selya in the

First Circuit, which were articulated in *Securities Industry Ass'n v. Connolly* (1st Cir. 1989), 883 F.2d 1114, *cert. denied* (1990), 495 U.S. 956, 110 S. Ct. 2559, 109 L. Ed. 2d 742.

Judge Selya considered "[i]ncreased resort to the courts" as the cause for "tumefaction of already-swollen court calendars." He refers to arbitration as "a contractual device that relieves some of the organic pressure by operating as a shunt, allowing parties to resolve disputes outside of the legal system." *Connolly*, 883 F.2d at 1116. He states that "[t]he hope has long been that the Act could serve as a therapy for the ailment of the crowded docket." *Connolly*, 883 F.2d at 1116. He then bemoans that fact that, "[a]s might be expected, there is a rub: the patient, and others in interest, often resist the treatment." *Connolly*, 883 F.2d at 1116.

Judge Selya refers to the preference in the various state jurisdictions to resolve disputes according to traditional notions of fairness, and then suggests that "[t]he FAA was enacted to overcome this 'anachronism'." *Connolly*, 883 F.2d at 1119 (citation omitted). He considers it the role of federal courts to be "on guard for artifices in which the ancient suspicion of arbitration might reappear." *Connolly*, 883 F.2d at 1119.

This type of arrogance not only reflects an intellectual detachment from reality, but a self-serving disregard for the purposes for which courts exist.

With all due respect, Judge Selya's opinion illustrates an all too frequent preoccupation on the part of federal judges with their own case load and a total lack of consideration for the rights of individuals. Nowhere in Judge Selya's lengthy opinion is there any consideration for the total lack of procedural safeguards inherent in the arbitration process. Nowhere in his opinion does he consider the financial hardship that contracts, like the one in this

case, impose on people who simply cannot afford to enforce their rights by the process that has been forced upon them. Nowhere does Judge Selya acknowledge that the "patient" (presumably courts like this one) who resists the "treatment" (presumably the imposition of arbitration in lieu of justice) has a case load typically three times as great as Justice Selya's case load.

The notion by federal judges, like Judge Selya, that people like the Casarottos have knowingly and voluntarily bargained and agreed to resolve their contractual disputes or tort claims by arbitration, is naive at best, and self-serving and cynical at worst. To me, the idea of a contract or agreement suggests mutuality. There is no mutuality in a franchise agreement, a securities brokerage agreement, or in any other of the agreements which typically impose arbitration as the means for resolving disputes. National franchisors, like the defendant in this case, and brokerage firms, who have been the defendants in many other arbitration cases, present form contracts to franchisees and consumers in which choice of law provisions and arbitration provisions are not negotiable, and the consequences of which are not explained. The provision is either accepted, or the business or investment opportunity is denied. Yet these provisions, which are not only approved of, but encouraged by people like Judge Selya, do, in effect, subvert our system of justice as we have come to know it. If any foreign government tried to do the same, we would surely consider it a serious act of aggression.

Furthermore, if the Federal Arbitration Act is to be interpreted as broadly as some of the decisions from our federal courts would suggest, then it presents a serious issue regarding separation of powers. What these interpretations do, in effect, is permit a few major corporations to draft contracts regarding their relationships with others that immunizes them from accountability under the laws

of the states where they do business, and by the courts in those states. With a legislative act, the Congress, according to some federal decisions, has written state and federal courts out of business as far as these corporations are concerned. They are not subject to California's labor laws or franchise laws, they are not subject to our contract laws or tort laws. They are, in effect, above the law.

These insidious erosions of state authority and the judicial process threaten to undermine the rule of law as we know it.

Nothing in our jurisprudence appears more intellectually detached from reality and arrogant than the lament of federal judges who see this system of imposed arbitration as "therapy for their crowded dockets." These decisions have perverted the purpose of the FAA from one to accomplish judicial neutrality, to one of open hostility to any legislative effort to assure that unsophisticated parties to contracts of adhesion at least understand the rights they are giving up.

It seems to me that judges who have let their concern for their own crowded docket overcome their concern for the rights they are entrusted with should step aside and let someone else assume their burdens. The last I checked, there were plenty of capable people willing to do so.

/s/ Terry Trieweiler
Justice

Justice Fred J. Weber dissents as follows:

I respect the majority opinion in its expression of the deeply held conviction that arbitration of the type expressed in the contract in this case should not be enforced in Montana and thereby deprive the parties of access to the court system. The answer to such a judicial approach was stated by the United States Supreme Court in Volt Info. Sciences v. Bd. of Trustees (1989), 489 U.S. 468, 478, 109 S.Ct. 1248, 1255, 103 L.Ed.2d 488, 497, in which the United States Supreme Court stated:

> The Act [Federal Arbitration Act] was designed "to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate," . . . and place such agreements "upon the same footing as other contracts," . . . Section 2 of the Act therefore declares that a written agreement to arbitrate in any contract involving interstate commerce or a maritime transaction "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." (Citations omitted.)

I specifically disagree with the majority opinion's refusal to enforce the agreement to arbitrate in the present case.

Issue I

As stated in the majority opinion: Based on conflict of law principles, is the franchise agreement entered into between the Casarottos and DAI governed by Connecticut law or Montana law?

I point out that the issue as stated by the parties essentially was whether an out-of-state corporation can avoid Montana Arbitration Act's conspicuous notice requirement by claiming preemption under the FAA?

The majority opinion refers to this Court's 1991 case of *Emerson v. Boyd*. In determining whether a contract dispute arose on an Indian reservation, that case adopted

language from *R.J. Williams Co.*, a Ninth Circuit case with regard to the factors to be used to determine whether an action did arise on the reservation. In contrast to the present case, *Emerson v. Boyd* did not contain an agreed choice of law as is present in this case. I do not find this to be appropriate authority.

The majority opinion on this issue concludes that the Montana Legislature had determined that its citizens are entitled to notice before entering into an agreement which will limit their future resolution of disputes to a procedure inconvenient, expensive and devoid of procedural safeguards—and further concludes that the notice requirements of § 27-5-114, MCA, established a fundamental public policy in this State which is contrary to the policy of the Connecticut law. On the basis of those conclusions, the majority opinion further concludes that the law of Montana governs. I do not agree with that conclusion.

The key parts of § 27-5-114, MCA, which apply to this issue are the following:

> Validity of arbitration agreement—exceptions. (1) A written agreement to submit an existing controversy to arbitration is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract.
>
> . . .
>
> (4) Notice that a contract is *subject to arbitration pursuant to this chapter shall be typed in underlined capital letters on the first page* of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration. (Emphasis supplied.)

Our question then becomes whether the contract here is subject to "arbitration pursuant to this chapter" so that the notice must be typed in underlined capital letters on the first page of the contract. Two specific paragraphs of the contract are controlling here. Section 10(c) of the contract stated in pertinent part:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut, . . .

Section 12 of the agreement further stated:

> 12. This Agreement shall be governed by and construed in accordance with the laws of the State of Connecticut and contains the entire understanding of the parties. Other than the representations contained in the Agreement, the Offering Circular and advertising materials of the Franchisor, no other representations have been made to or relied upon by the Franchisee except as set forth below: (None are set forth)

When the foregoing contract provisions are compared to subsection (4) of § 27-5-114, MCA, it is apparent that these contract provisions do not fit within the statute. There is no statement in the Franchise Agreement which specifies that the contract is subject to arbitration pursuant to Montana law or to the Uniform Arbitration Act as enacted in Montana under §§ 27-5-111 to 115, MCA.

I conclude that the contract provisions are controlling in this instance and that the contract between the parties is not by its terms subject to Montana law or arbitration under Monana law. In fact the reverse is true. As above specified, the agreement requires that the commercial rules of the American Arbitration Association shall be applied in any arbitration, and also provides that the agreement is governed by and construed under the laws of the State of Connecticut. This clearly rebuts any suggestion that this particular contract is subject to arbitration pursuant to the laws of the Sate of Montana and in particular § 27-5-114, MCA. I therefore conclude that the notice requirement of § 27-5-114, MCA, does not in

any way establish a fundamental public policy which is applicable to the present contract.

I further point out that the reference to Restatement (Second) of Conflict of Laws, § 188 (1971), is applicable only in the absence of an "effective" choice of law and I conclude there was such an effective choice of law in the present case.

Issue II

If the contract is governed by Montana law, is the notice requirement of § 27-5-114(4), MCA, of Montana's Uniform Arbitration Act, preempted by the Federal Arbitration Act found at 9 U.S.C. § 1-15 (1988)?

The majority opinion quotes the following from the 1987 United States Supreme Court opinion of *Perry v. Thomas*:

> . . . Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements. . . . Section 2, therefore, embodies a clear federal policy of requiring arbitration unless the agreement to arbitrate is not part of a contract evidencing interstate commerce . . . *We see nothing in the Act indicating that the broad principle of enforceability is subject to any additional limitations under state law*. . . . (Emphasis supplied.)

The affidavit of the vice president of DAI establishes without contradiction that the present agreement to arbitrate is part of a contract in interstate commerce:

> 5. Before July 1991, DAI was a corporation organized under the laws of the State of Connecticut, with a principal place of business at 325 Bic Drive, Milford, CT 06460. On July 1, 1991, DAI of Florida merged with DAI of Connecticut, leaving DAI of Florida as a surviving corporation.
>
> 6. DAI has sold a total of 8500 Subway franchises in the United States and estimates that there

are approximately 7400 stores in operation world wide.

Clearly the present agreement to arbitrate is part of a contract evidencing interstate commerce so the Federal Arbitration Act is applicable.

The majority opinion analyzes the United States Supreme Court's decision in *Volt* and from that concludes that the nature of the inquiry is whether Montana's notice requirement under § 27-5-114(4), MCA, would undermine the goals and policy of the FAA and further concludes it does not. I disagree with that analysis of *Volt*.

In *Volt*, Volt petitioned the California court to compel arbitration of a dispute and the defendant moved to stay arbitration pursuant to California law. The California statute permitted the court to stay arbitration pending resolution of related litigation between a party to the arbitration agreement and third parties not bound by it. The California court stayed the arbitration proceedings pending the outcome of the litigation. In considering whether the California code section in question was preempted by the FAA, the United States Supreme Court stated:

> The FAA contains no express preemptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration. . . . But even when congress has not completely displaced state regulation in an area, state law may nonetheless be preempted to the extent that it actually conflicts with federal law—that is, to the extent that it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." . . . The question before us, therefore, is whether application of Cal. Civ. Proc. Cod. Ann. § 1281.2(c) to stay arbitration under this contract in interstate commerce, in accordance with the terms of the arbitration agreement itself, would undermine the goals and policies of the FAA. We conclude it would not.
>
> . . .
>
> . . . Accordingly, we have recognized that the FAA does not require parties to arbitrate when they have not agreed to do so. See id., at 219, 84 L.Ed.2d 158, 105 S.Ct. 1238. (The Act "does not mandate the arbitration of all claims"), nor does it prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement. *It simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms. . . .* (Citations omitted.) (Emphasis supplied.)

Volt, 489 U.S. at 477-78, 109 S.Ct. at 1255, 103 L.Ed. 2d at 499-500. The court further stated and concluded:

> Arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit . . . Where, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of FAA, even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward.

Volt, 489 U.S. at 479, 109 S.Ct. at 1256, 103 L.Ed. at 500. It is essential to keep in mind that the key holding of *Volt* as expressed by the United States Supreme Court was that the agreement to arbitrate should be enforced according to its terms—and that allowed application of the California law which provided for the stay in proceedings where other parties besides the arbitration parties were involved in the case. That conclusion does not assist the majority opinion. The rationale of the *Volt* de-

cision in the present case would require enforcement of the contract as agreed upon by the parties—which would require application of the American Arbitration Association rules as well as the laws of the State of Connecticut. I conclude that the contract here should be enforced to require application of the American Arbitration Association Rules and the laws of the State of Connecticut under *Volt*.

In addition to the conclusion reached under *Volt*, I will discuss several cases which have concluded that a statutory provision similar to Montana's statutory requirement of a statement in capital letters on page one of a contract is in conflict with the Federal Arbitration Act and therefore not enforceable. In David L. Threlkeld and Co. v. Metallgesellschaft Ltd. (2nd Cir. 1991), 923 F.2d 245, Threlkeld asserted that Vermont law voided any arbitration agreement which does not have a specific acknowledgement of arbitration signed by both parties and where the agreement to arbitrate has not been displayed prominently in the contract. The circuit court acknowledged that Threlkeld was correct in asserting that the contracts did not comply with the rigorous Vermont standard. The circuit court then concluded that the Vermont statute is preempted by federal law and stated:

> Because federal arbitration law governs this dispute, we must determine whether the Vermont statute is sufficiently consistent with federal law that the two may peacefully coexist. . . . The First Circuit has recently held that restrictive provisions similar to those found in the Vermont statute are preempted by federal law. . . .
>
> We agree with the First Circuit that state statutes such as the Vermont statute directly clash with the Convention and with the Arbitration Act because they effectively reincarnate the former judicial hostility towards arbitration. Accordingly *we hold that the Convention and the Arbitration Act preempt the Vermont statute, and that the . . . arbitration provisions, as drafted, are not enforceable.* Emphasis supplied.)

Threlkeld, 923 F.2d at 250. *Threlkeld* is clear authority for concluding that the Montana statute directly clashes with the Federal Arbitration Act and therefore is not enforceable.

In a similar manner, Bunge Corp. v. Perryville Feed and Produce (Mo.1985), 685 S.W.2d 837, addresses a similar issue. As pointed out by the Missouri court in *Bunge*, the Missouri statute is based on the Uniform Arbitration Act (as is the Montana statute) and contains a provision that each contract shall include a statement in 10 point capital letters which reads substantially as follows: THIS CONTRACT CONTAINS A BINDING ARBITRATION PROVISION WHICH MAY BE ENFORCED BY THE PARTIES. The Missouri Supreme Court then stated:

> It is clear that § 435.460, if applied to this case, seeks to impose a requirement for contracts to arbitrate which is in addition to the requirements of the Federal Arbitration Act. All that is apparently required under that act is contractual language and format sufficient for an ordinarily written contract. . . . *If the Missouri statute applies, then a commercial contract sufficient under federal law would be in violation.*
>
> There is a manifest violation of the supremacy clause if our statute is so applied. The Federal Arbitration Act was passed by Congress pursuant to its power to regulate interstate commerce . . . Any requirement of state law which adds a burden not imposed by Congress is in derogation of the Congressional power, and pro tanto invalid. A very recent case so holding is *Southland Corp. v. Keeting*. . .
>
> We do not hold that the Missouri statute is unconstitutional. We simply hold that it may not be

applied to defeat the arbitration provision of a contract which is within the coverage of the federal statute. . . . (Citations omitted.) (Emphasis supplied.)

Bunge, 685 S.W.2d at 839. The *Bunge* conclusion is directly applicable to our present case. If our Montana statute applies to the present case, then a commercial contract sufficient under federal law would be in violation of the Montana statute even though it meets the requirement of the Federal Arbitration Act. As a result, even if we accept the majority opinion conclusion that the Montana code section applies, I would hold that Montana law may not be applied to defeat the arbitration principles of a contract which is clearly within the coverage of the Federal Arbitration Act.

The District Court held that the Federal Arbitration Act required that the present suit should be stayed until the arbitration has been held in accordance with the terms of the agreement. I would affirm that holding.

/s/ Fred J. Weber
Justice

Chief Justice J. A. Turnage concurs in the foregoing dissent.

/s/ J. A. Turnage
Chief Justice

Justice Karla M. Gray, dissenting.

I respectfully dissent from the Court's opinion on both issues presented therein. I write separately because the reasons for my dissent are not altogether identical to those which form the basis for Justice Weber's dissent.

With regard to issue one, I conclude that the franchise agreement entered into between the Casarottos and DAI was governed by Connecticut law. It is my view that the Court's analysis of this issue is incomplete and erroneous.

I agree with the Court's synopsis of our decision in *Emerson v. Boyd* and, on the basis that the agreement before us does include a choice of law provision, on the inapplicability of that decision to the case before us. In my view, *Youngblood* also is not on point here, since that case did not relate to whether a statute represents a statement of public policy by the Montana legislature and, if so, the extent of that statement of public policy.

I agree with the Court that Montana has a materially greater interest than Connecticut in the contract issue presented and that, absent an "effective" choice of law by the parties, Montana law would apply. I disagree with the remainder of the Court's discussion and analysis on this issue.

My primary concern is that the Court neither presents nor discusses the specific language contained in the statutory notice requirement. That statute provides that "[n]otice *that a contract is subject to arbitration pursuant to this chapter* shall be typed in underlined capital letters on the first page of the contract; . . . ." Section 27-5-114(4), MCA. By its terms, the franchise agreement before us is subject to Connecticut law, not "this chapter"—the MUAA. The legislature's specific limitation on the applicability of the notice requirement is clear and unambiguous; under such a circumstance, we are obligated to so interpret it (Curtis v. Dist. Court of

21st Jud. Dist. (Mont. 1994), 879 P.2d 1164, 1166, 51 St.Rep. 776, 778) and conclude that the notice requirement is *not* applicable to the contract before us. Since the statute is inapplicable by its terms to the contract, it cannot form the basis of a public policy broad enough to negate the parties' choice of Connecticut law.

The Court does not even address the specific statutory language, preferring to resort inappropriately to generalized legislative history for its overly broad interpretation of the extent to which the notice requirement applies and the extent to which the legislature adopted the notice rquirement as a public policy. Had the legislature intended the notice requirement to apply to every arbitration agreement entered into by a citizen or resident of Montana, notwithstanding that some other jurisdiction's law would otherwise apply, it would have done so; it did not. It is inappropriate for the Court to judicially broaden the legislature's clear statute in the guise of a conflict of law analysis.

With regard to issue two, I conclude that even if the Court were correct regarding the applicability of Montana's notice requirement under conflict of law principles, that requirement is preempted by the Federal Arbitration Act (FAA). Therefore, I also dissent from the Court's opinion on this issue.

The Court suggests that the United States Supreme Court's *Volt* decision was a departure from its earlier *Southland/Perry* line of cases. It then presents an inadequate analysis of *Volt*. Finally, the Court concludes, purportedly under a *Volt* analysis, that Montana's notice requirement does not undermine the goals and policies of the FAA. Nothing could be further from the truth.

In *Southland*, the United States Supreme Court was faced with a California statute which required judicial consideration of certain claims brought under it; the California courts held that the statute precluded arbitration

under an agreement containing an arbitration provision. Determining that the FAA was a substantive rule applicable in state courts by which Congress intended "to foreclose state legislative attempts to undercut the enforceability of arbitration agreements," the Supreme Court held that the California statute violated the supremacy clause. *Southland* was decided in 1984.

In 1987, the Supreme Court decided *Perry*, another California case involving a different California statute which—by its terms—provided that legal actions for the collection of wages could be maintained notwithstanding an agreement to arbitrate such claims. Again the California courts denied a motion to compel arbitration under the parties' agreement, favoring their legislature's effort to render arbitration agreements unenforceable. And again the United States Supreme Court reversed, quoting its *Southland* language that Congress intended to foreclose state legislatures from undercutting the enforceability of arbitration agreements. For additional clarity, the Supreme Court added " 'We see nothing in the [FAA] indicating that the broad principle of enforceability is subject to any additional limitations under state law.' " *Perry*, 482 U.S. at 489-90 (citations omitted). *Southland* and *Perry* are, as the Court notes, consistent with each other.

In 1989, the Supreme Court decided *Volt*. There, faced with yet another California statute and another decision from the California courts denying a motion to compel arbitration on the basis of the state statute, the Supreme Court affirmed. Contrary to this Court's suggestion, *Volt* is entirely consistent with—and not a retrenchment from—*Southland* and *Perry*. All three cases require this Court to conclude that Montana's notice requirement is preempted by the FAA.

In *Volt*, the parties had specifically agreed to submit disputes under their contract to arbitration under the California arbitration statutes. The California arbitration

statute at issue in *Volt* differed markedly from those in *Southland* and *Perry*. As noted above, the earlier cases involved statutes which clearly undercut the enforceability of arbitration agreements. In *Volt*, however, the statute—part of the California Arbitration Act—merely allowed a court to *stay* arbitration pending resolution of related litigation; the right to arbitrate remained. The issue before the Supreme Court was the same as in the earlier cases: whether the stay provision would undermine the goals and policies of the FAA.

The Supreme Court reiterated that the purpose of the FAA was to *enforce* arbitration agreements entered into by parties, and specifically noted the parties' agreement to apply California's arbitration rules, one of which permitted the stay of arbitration pending related litigation. On these facts, including the parties' choice of California arbitration law and that that law permitted a stay—but not a voiding—of arbitration, the Supreme Court held that enforcing the California stay provision did not frustrate the policy behind the FAA of enforcing arbitration agreements.

The Court's opinion fails—or refuses—to recognize two important differences between *Volt* and the case presently before us. First, the Supreme Court in *Volt* relied heavily on the fact that the parties had affirmatively chosen California arbitration law, including the stay statute, to govern their agreement. Second, the stay statute did not undercut, undermine or render unenforceable the parties' agreement to arbitrate.

Here, the parties did not affirmatively choose Montana arbitration law, which includes the notice requirement, to govern their agreement. They chose Connecticut law.

Moreover, it is clear under *Southland*, *Perry* and *Volt* that Montana's notice requirement is preempted by the Federal Arbitration Act. The reason for this constitutes the second important difference between this case and

Volt: here, the application of the notice requirement is not merely a procedural matter; indeed, it totally undermines the purposes of the FAA by rendering the parties' arbitration agreement unenforceable. This is precisely the result prohibited by the United States Supreme Court in all three of the cases discussed herein and in the Court's opinion on this issue.

I would affirm the District Court's grant of defendants' motion to stay judicial proceedings pending arbitration of plaintiffs' claims.

/s/ Karla M. Gray
Justice

Chief Justice J.A. Turnage joins in the foregoing dissent of Justice Karla M. Gray.

/s/ J.A. Turnage
Chief Justice

[Filed Aug. 31, 1995]

IN THE SUPREME COURT
OF THE STATE OF MONTANA
1995

No. 93-488

PAUL CASAROTTO and PAMELA CASAROTTO,
Plaintiffs and Appellants,

v.

NICK LOMBARDI and DOCTOR'S ASSOCIATES, INC.,
Defendants and Respondents,

and

DANIEL L. and DEB HUDSON,
and D&D SUBWAY CORPORATION,
Defendants.

Appeal from District Court of the Eighth Judicial District,
In and for the County of Cascade,
The Honorable John M. McCarvel, Judge presiding

Submitted: August 22, 1995

Decided: August 31, 1995

Justice Terry N. Trieweiler delivered the opinion of the Court.

Plaintiffs Paul and Pamela Casarotto filed this suit in the District Court for the Eighth Judicial District in Cascade

County to recover damages which they claim were caused by the defendants' breach of contract and tortious conduct. Defendants Nick Lombardi and Doctor's Associates, Inc. (DAI) moved the District Court for an order dismissing plaintiffs' complaint, or in the alternative, staying further judicial proceedings pending arbitration of plaintiffs' claims pursuant to a provision in DAI's franchise agreement with plaintiffs which required that disputes "arising out of or relating to" that contract be settled by arbitration. The District Court granted defendants' motion, and ordered that further judicial proceedings be stayed until arbitration proceedings were completed in accordance with the terms of the parties' agreement. Plaintiffs appealed from that order, and on December 15, 1994, we reversed the order of the District Court and remanded this case to that court for further proceedings. *Casarotto v. Lombardi* (1994), 268 Mont. 369, 886 P.2d 931. Following this Court's decision, the defendants petitioned the Supreme Court of the United States for a writ of certiorari. That petition was granted, and on June 12, 1995, the United States Supreme Court ordered that the December 15, 1994, judgment of this Court be vacated, and remanded this case to the Supreme Court of Montana for further consideration in light of that Court's decision in *Allied-Bruce Terminix Cos. v. Dobson* (1995), 513 U.S. ——, 115 S. Ct. 834, 130 L. Ed. 2d 753. Having further considered our prior decision in light of *Dobson*, we now reaffirm and reinstate our prior opinion.

FACTUAL BACKGROUND

Paul and Pamela Casarotto entered into a franchise agreement with DAI which allowed them to open a Subway Sandwich Shop in Great Falls, Montana. DAI's franchise agreement included on page nine a provision which required that controversies or claims related to the contract shall be settled by arbitration in Bridgeport, Connecticut. However, the franchise agreement did not include

notice on the front page to the effect that the contract was subject to arbitration, as required by § 27-5-114(4), MCA.

The Casarottos filed this action in the District Court based on their allegations that DAI breached its agreement with them, defrauded them, and engaged in other tortious conduct, all of which resulted in loss of business and the resulting damage.

DAI moved to dismiss the Casarottos' claim or to stay further judicial proceedings pending arbitration pursuant to the arbitration provision in its franchise agreement. The District Court granted DAI's motion to stay further judicial proceedings pursuant to 9 U.S.C. § 3, which is part of the Federal Arbitration Act found at 9 U.S.C. §§ 1-15 (1988).

On appeal from the District Court's order, we considered whether Montana's notice requirement was preempted by the Federal Arbitration Act in light of the U.S. Supreme Court's recent decision in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University* (1989), 489 U.S. 468, 109 S. Ct. 1248, 103 L. Ed. 2d 488. In that case, the Supreme Court stated that:

> The FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration. But even when Congress has not completely displaced state regulation in an area, state law may nonetheless be preempted to the extent that it actually conflicts with federal law—that is, to the extent that it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 U.S. 52, 67, 61 S.Ct. 399, 404, 85 L.Ed.2d 581 (1941). *The question before us, therefore, is whether application of Cal.Civ.Proc. Code Ann. § 1281.2(c) to stay arbitration under this*

> *contract in interstate commerce, in accordance with the terms of the arbitration agreement itself, would undermine the goals and policies of the FAA. We conclude that it would not.*

Volt, 489 U.S. at 477-78, 109 S. Ct. at 1255 (citation omitted; emphasis added).

Based on the cited language from *Volt*, we concluded that the nature of our inquiry was whether Montana's notice requirement found at § 27-5-114(4), MCA, would "undermine the goals and policies of the FAA." We concluded that it does not. *Casarotto*, 886 P.2d at 931. We explained our conclusion as follows:

> Our conclusion that Montana's notice requirement does not undermine the policies of the FAA is based on the Supreme Court's conclusion that it was never Congress's intent when it enacted the FAA to preempt the entire field of arbitration, and its further conclusion that the FAA does not require parties to arbitrate when they have not agreed to do so. That Court held that the purpose of the FAA is simply to enforce arbitration agreements into which parties had entered, and acknowledged that the interpretation of contracts is ordinarily a question of state law. *Volt*, 489 U.S. at 474, 109 S.Ct. at 1253.
>
> Presumably, therefore, the Supreme Court would not find it a threat to the policies of the Federal Arbitration Act for a state to require that before arbitration agreements are enforceable, they be entered knowingly. To hold otherwise would be to infer that arbitration is so onerous as a means of dispute resolution that it can only be foisted upon the uninformed. That would be inconsistent with the conclusion that the parties to the contract are free to decide how their disputes should be resolved.
>
> Montana's notice requirement does not preclude parties from knowingly entering into arbitration

> agreements, nor do our courts decline to enforce arbitration agreements which are entered into knowingly.
>
> Therefore, we conclude that Montana's notice statute found at § 27-5-114(4), MCA, would not undermine the goals and policies of the FAA, and is not preempted by 9 U.S.C. § 2 (1988).

Casarotto, 886 P.2d at 938-39.

On January 18, 1995, subsequent to our decision in this case, the U.S. Supreme Court decided *Dobson*. On June 12, 1995, the same Court vacated our prior *Casarotto* decision and remanded the matter to this Court for further consideration in light of the *Dobson* decision.

In *Dobson*, the plaintiffs were the assignees of a contract with Terminix for life-time protection against termites. They sued Terminix in Alabama state court when they found their house "swarming with termites." Terminix moved the court for a stay pursuant to § 2 of the Federal Arbitration Act (9 U.S.C. § 2 (1988)) so that arbitration could proceed pursuant to a provision for arbitration in the termite protection plan. The stay was denied. The Supreme Court of Alabama upheld the denial on the basis of Ala. Code § 8-1-41(3) (1993), which made written, predispute arbitration agreements invalid and unenforceable. The Alabama court concluded that its state statute was not preempted by the Federal Arbitration Act because the connection between the termite contract and interstate commerce was too slight.

> In the court's view, the Act applies to a contract only if " 'at the time [the parties entered into the contract] and accepted the arbitration clause, they *contemplated* substantial interstate activity.' " Despite some interstate activities (*e.g.*, Allied-Bruce, like Terminix, is a multistate firm and shipped treatment and repair material from out of state), the court found that the parties "contemplated" a transaction that was primarily local and not "substantially" interstate.

Dobson, 115 S. Ct. at 837 (citations omitted).

Before addressing the issue presented, the *Dobson* majority reiterated its conclusion that the purpose of the Federal Arbitration Act was to "overcome judicial hostility to arbitration agreements and that applies in both federal and state courts." *Dobson*, 115 S. Ct. at 835. The Court then went on to conclude that the language in § 2 of the Act which applied its provisions to any "contract evidencing a transaction involving commerce" had broader significance than the words of art "in commerce," and therefore, covered more than persons or activities "within the flow" of interstate commerce. *Dobson*, 115 S. Ct. at 839. The Court held that the word "involving," like "affecting," signaled an intent on the part of Congress "to exercise Congress's commerce power to the full," *Dobson*, 115 S.Ct. at 841, and secondly that the Act's preemptive force applies to transactions which, in fact, involve interstate commerce, even though a connection to interstate commerce may not have been contemplated by the parties at the time they entered into the agreement. For these reasons, the judgment of the Supreme Court of Alabama was reversed. *Dobson*, 115 S. Ct. at 843.

After careful review, we can find nothing in the *Dobson* decision which relates to the issues presented to this Court in this case. Our prior *Casarotto* decision did not involve state law which made arbitration agreements invalid and unenforceable. Our state law simply requires that the parties be adequately informed of what they are doing before they enter into an arbitration agreement. Our decision did not involve an analysis of what was meant by "involving commerce" or "affecting commerce" or "in commerce." We assumed, in the *Casarotto* decision, that the transaction with which we were concerned involved

interstate commerce, and that any state law which frustrated the purposes of the Federal Arbitration Act would be preempted.

Finally, there is no suggestion in the *Dobson* decision that the principles from *Volt* on which we relied have been modified in any way. To our knowledge, it is still the law, therefore, that state law is only preempted to the extent that it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Volt*, 489 U.S. at 477, 109 S. Ct. at 1255 (citing *Hines v. Davidowitz* (1941), 312 U.S. 52, 67, 61 S. Ct. 399, 404, 85 L. Ed. 2d 581).

While the *Dobson* decision does include a discussion extolling the virtues of arbitration as a "less expensive alternative to litigation," *Dobson*, 115 S. Ct. at 843 (apparently based on input from the American Arbitration Association), and while that conclusion is at odds with facts set forth in Justice Trieweiler's concurring opinion to our earlier decision, the concurring opinion was not the basis for our decision.

For these reasons, we conclude, after thorough review of our earlier decision in light of the U.S. Supreme Court's decision in *Dobson*, that the decisions are not inconsistent, and therefore, that there is no basis for modifying or reversing our earlier opinion. We reaffirm and reinstate our opinion dated December 15, 1994, in the above matter, and remand this case to the District Court for further proceedings consistent with this opinion.

/s/ Terry N. Trieweiler
Justice

We concur:

/s/ James C. Nelson
/s/ William E. Hunt, Sr.
/s/ W. William Leaphart
Justices

Justice W. William Leaphart, specially concurring.

Justice John C. Harrison was in the majority in this Court's initial decision in Casarotto v. Lombardi (1994), 268 Mont. 369, 886 P.2d 931. Justice Harrison has since retired. As the successor to Justice Harrison, it is incumbent on me to review that decision in light of the remand from the United States Supreme Court. Having reviewed the *Casarotto* decision, I specially concur with the Court's conclusion that Montana's notice requirement in § 27-5-114(4), MCA, does not undermine the goals and policies of the FAA and is not preempted by 9 U.S.C. § 2 (1988). I have also reviewed the United States Supreme Court's decision in Allied-Bruce Terminix Cos. v. Dobson (1995), 115 S.Ct. 834, 130 L.Ed.2d 753, and I see no reason why the principles enunciated in that decision should have any effect upon this Court's decision in *Casarotto*.

In *Dobson*, the United States Supreme Court held that the FAA preempts anti-arbitration state statutes which invalidate arbitration agreements. Section 27-5-114(4), MCA, cannot be characterized as anti-arbitration nor does it invalidate arbitration agreements. On the contrary it is one section of Montana's Uniform Arbitration Act which specifically recognizes arbitration agreements: "A written agreement to submit an existing controversy to arbitration is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract." Section 27-5-114(1), MCA. The notice requirement of subsection (4) merely protects the consumer by requiring that notice of an arbitration provision be conspicuously placed on the front page of the contract. This does not undermine the pro-arbitration policy of the FAA. Rather, it furthers the policy of meaningful and consensual arbitration by helping ensure that the consumer who signs what is most often a nonnegotiated, form contract, knowingly agrees to arbitration in the event of a dispute. I see no inconsistency between *Dobson* and our decision in *Casa-*

rotto and I specially concur in the Court's decision to reaffirm and reinstate its December 15, 1994 opinion.

/s/ W. William Leaphart
Justice

Justice Karla M. Gray, dissenting.

I dissent from the Court's opinion and order and its reinstatement of its prior opinion in this case. My dissent is based on the procedures used by the Court in addressing the United States Supreme Court's vacating of our earlier opinion and remanding for our reconsideration based on its decision in Allied-Bruce Terminix Cos. v. Dobson (1995), 115 S.Ct. 834, 130 L.Ed.2d 753. I also dissent from the Court's conclusion that nothing in the *Dobson* case relates to the issues presented to this Court. In dissenting, I also reaffirm and reinstate my earlier dissent in this case.

A remand for reconsideration to this Court from the United States Supreme Court is an uncommon occurrence for which we have no procedural rules or practices in place. Counsel for the parties were left without guidance as to how they should proceed in order to be heard during this phase of the case. Counsel for the defendants/respondents requested the opportunity to brief the issues raised by the United States Supreme Court's remand and to present oral argument. Without so much as a mention of this request, the Court apparently denies it. While one can only speculate on the reasons for such an implicit decision, one must assume that the Court is simply unwilling to consider any analysis that would require a change in the result it remains determined to reach. I cannot join in such an arrogant and cavalier approach to this important case on remand from the United States Supreme Court.

More importantly, I disagree with the Court's conclusion that nothing in *Dobson* relates to the issues before us. While I agree that the substantive issue addressed at length in *Dobson* is not before us here, I read more importance into the early language in *Dobson* than does the Court. In *Dobson*, the United States Supreme Court reiterates the fundamental premise of the Federal Arbitration Act by citing to *Volt*, the very case which this Court

erroneously interprets and on which it premises its erroneous decision, for the proposition that "the basic purpose of the Federal Arbitration Act is to overcome courts' refusals to enforce agreements to arbitrate." *Dobson*, 115 S.Ct. at 838; citing Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ. (1989), 489 U.S. 468, 474. The Supreme Court goes on to say that "[n]othing significant has changed in the 10 years subsequent to *Southland*; no later cases have eroded *Southland's* authority[.]" *Dobson*, 115 S.Ct. at 839. It is this latter statement on which I believe we must focus in reconsidering our decision here. The Court refuses to do so.

I continue to believe that this Court erroneously interprets *Volt*, which was decided by the Supreme Court five years after *Southland*. *Volt* is clearly distinguishable on its facts from the case before this Court and cannot properly serve as a basis for the result the Court reaches. *Volt* is neither inconsistent with, nor a retrenchment from, *Southland*, as this Court suggested in its earlier opinion and suggests again today. This is the message I take from the Supreme Court's statement in *Dobson* that "no later cases have eroded *Southland*'s authority;" this is the portion of this Court's earlier opinion to which I believe the Supreme Court was directing our attention on remand.

For the reasons stated in my earlier dissent, it is my view that application of Montana's notice statute is preempted by the Federal Arbitration Act in this case because application of that statute undercuts, undermines and renders unenforceable the parties' agreement to arbitrate. This view is entirely consistent both with *Southland* and with a proper interpretation of *Volt*. Therefore, I dissent from the Court's opinion and order and reinstate my prior dissent in this case.

/s/ Karla M. Gray
Justice

Chief Justice J.A. Turnage and Justice Fred J. Weber join in the foregoing dissent of Justice Karla M. Gray.

/s/ J.A. Turnage
Chief Justice

/s/ Fred J. Weber
Justice

[Filed Sept. 19, 1995]

IN THE SUPREME COURT OF THE
STATE OF MONTANA

D.C. Case No. BDV 92-860

S.C. Case No. 93-488

June Term A.D. 1995

REMITTITUR

The Chief Justice of the Supreme Court of the State of Montana:

To the Honorable Judge of the District Court of the Eighth Judicial District, in and for the County of Cascade, Greetings:

WHEREAS, In the said District Court in a cause between PAUL CASAROTTO and PAMELA CASAROTTO, Plaintiffs and Appellants, and NICK LOMBARDI and DOCTOR'S ASSOCIATION, INC., Defendants and Respondents, and DANIEL L. and DEB HUDSON, and D&D SUBWAY CORPORATION, Defendants, wherein the judgment of the District Court entered in said cause on the 2nd day of June, A.D. 1993 was in favor of Defendants and Respondents and against Plaintiffs and Appellants which was brought into The Montana Supreme Court by virtue of an appeal,

AND WHEREAS, in the June term of the Court in the year of our Lord, One Thousand Nine-Hundred and Ninety-Five the cause came before The Montana Supreme Court on remand by the United States Supreme Court.

WHEREUPON, On remand and reconsideration, it is now here ordered and adjudged that this Court's Opinion issued December 15, 1994 is reaffirmed and reinstated.

WITNESS: The Honorable J.A. Turnage, Chief Justice of the Supreme Court of the State of Montana, this 19th day of September, A.D. 1995.

/s/ Ed Smith
Clerk of the Supreme Court
of the State of Montana

[SEAL]

[Filed in Montana Eighth Judicial District Court]

FRANCHISE OFFERING CIRCULAR FOR PROSPECTIVE FRANCHISEES AS REQUIRED BY THE FEDERAL TRADE COMMISSION 1988

DOCTOR'S ASSOCIATES, INC.

DATE OF ISSUANCE OF DISCLOSURE STATEMENT ————————

INFORMATION FOR PROSPECTIVE FRANCHISEES REQUIRED BY THE FEDERAL TRADE COMMISSION

———————

TO PROTECT YOU, WE'VE REQUIRED YOUR FRANCHISOR TO GIVE YOU THIS INFORMATION. *WE HAVEN'T CHECKED IT, AND DON'T KNOW IF IT'S CORRECT.* WHILE IT INCLUDES SOME INFORMATION ABOUT YOUR CONTRACT, DON'T RELY ON IT ALONE TO UNDERSTAND YOUR CONTRACT. READ ALL OF YOUR CONTRACT CAREFULLY. BUYING FRANCHISE IS A COMPLICATED INVESTMENT. TAKE YOUR TIME TO DECIDE. IF POSSIBLE, SHOW YOUR CONTRACT AND THIS INFORMATION TO AN ADVISOR, SUCH AS A LAWYER OR AN ACCOUNTANT. IF YOU FIND ANYTHING YOU THINK MAY BE WRONG OR ANYTHING IMPORTANT THAT'S BEEN LEFT OUT, YOU SHOULD LET US KNOW ABOUT IT. IT MAY BE AGAINST THE LAW.

THERE MAY ALSO BE LAWS ON FRANCHISING IN YOU STATE. ASK YOUR STATE AGENCIES ABOUT THEM.

FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

* * * *

FRANCHISE BROKERS (DEVELOPMENT AGENTS)

In certain areas of the country, the franchisor operates through Development Agents whose duties include franchise sales, site location assistance, training, and operational assistance to franchisees. Development Agents are generally franchisees of the franchisor and are typically selected from existing franchise owners. For their services rendered to the Company, Development Agents are paid a portion of the initial franchise fee and a portion of royalties collected.

Development Agents are prohibited from making any representations of sales or profits to prospective purchasers of franchises. Additionally, Development Agents are obligated to abide by all federal and state laws in the performance of their duties. Development Agents are independent contractors and not employees of the franchisor. The franchisor disclaims responsibility for any acts or statements made by Development Agents contrary to the disclosures made in the Offering Circular, the Franchise Agreement, the Operations Manual and Rules and related contracts.

As of the effective date of this Offering Circular, the Development Agents of the franchisor were as follows:

* * * *

The Franchise Agreement provides for binding arbitration of any claim or breach of the Agreement in accordance with the Commercial Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut. The cost of this proceeding is to be borne equally by the parties.

* * * *

[Filed in Montana Eighth Judicial District Court]

Franchise	4614
Owner Number	2730
Date Executed	4/25/88

FRANCHISE AGREEMENT

DOCTOR'S ASSOCIATES, INC.

with

PAUL S. CASAROTTO

FRANCHISE AGREEMENT

Agreement, this 25th day of April, 1988, between DOCTOR'S ASSOCIATES, INC., a Connecticut corporation located at Milford, Connecticut (hereinafter called the Company) and Paul S. Casarotto of Montana (hereinafter called the Franchisee, for one SUBWAY Sandwich Shop to be located in the State of Montana.

A. The Company is the owner of proprietary and other rights and interests in various service marks, trademarks and trade names used in its business including the trade name and service mark "SUBWAY".

B. The Company operates, and enfranchises others to operate, sandwich shops under the trade name and service mark SUBWAY using certain recipes, formulas, food preparation procedures, business methods, business forms and business policies it has developed. The Company has also developed a body of knowledge pertaining to the establishment and operation of sandwich shops. The Franchisee acknowledges that he does not presently know these recipes, formulas, food preparation procedures, business methods or business policies, nor does the Franchisee have these business forms or access to the Company's body of knowledge.

C. The Franchisee intends to enter the sandwich business and desires access to the Company's recipes, formulas, food preparation procedures, business methods, business forms, business policies and body of knowledge pertaining to the operation of a sandwich shop. In addition, the Franchisee desires access to information pertaining to new developments and techniques in the Company's sandwich business.

D. The Franchisee desires to participate in the use of the Company's rights in its service marks and trademarks in connection with the operation of one sandwich shop to be located at a site approved by the Company and the Franchisee.

E. The Franchisee understands that information received from the Company or from any of its officers, employees, agents or franchisees is confidential and has been developed with a great deal of effort and expense. The Franchisee acknowledges that the information is being made available to him so that he may more effectively establish and operate a sandwich shop.

F. The Company has granted, and will continue to grant to others, access to its recipes, formulas, food preparation procedures, business methods, business forms, business policies, body of knowledge pertaining to the operation of sandwich shops and information pertaining to new developments and techniques in its business.

G. The Company has and will continue to license others to use its service marks and trademarks in connection with the operation of sandwich shops at Company approved locations.

H. The Franchise Fee and Royalty constitute the sole consideration to the Company for the use by the Franchisee of its body of knowledge, systems and trademark rights.

I. The Franchisee acknowledges that he received the Company's franchise offering prospectus at or prior to the first personal meeting with a Company representative and at least ten (10) business days prior to the signing of this Agreement.

J. The Franchisee acknowledges that he understands that the success of the business to be operated by him under this Agreement depends primarily upon his efforts and that neither the Company or any of its agents or representatives have made any oral, written or visual representations or projections of actual or potential sales, earnings, net or gross profits.

AGREEMENT

Acknowledging the above recitals, the parties hereto agree as follows:

☒ 1. a. Upon execution of this Agreement, the Franchisee shall pay to the Company a Franchise Fee of $7,500.00 which shall not be refunded in any event; or

☐ b. Upon execution of this Agreement, the Franchisee shall pay to the Company a reduced Franchise Fee of $1,000.00 which shall not be refunded in any event. This reduction is being made available to the Franchisee in view of the fact that the Franchisee presently owns a franchise and all of his existing franchises are in full compliance with the Company's Operating Manual. In the event that the Franchisee is not in full compliance at the time a lease is executed for this franchise, the franchisee shall pay the Company the additional sum of $6,500.00

2. The Franchisee shall also pay to the Company, weekly, a Royalty equal to eight (8%) per cent of the gross sales from each sandwich shop which he operates throughout the term of this Agreement. "Gross sales" means all sales or revenues derived from the Franchisee's location exclusive of sales taxes.

3. The Company hereby grants to the Franchisee:

a. access to the Company's recipes, formulas, food preparation procedures, business methods, business forms, business policies and body of knowledge pertaining to the operation of a sandwich shop.

b. access to information pertaining to new developments and techniques in the Company's sandwich business.

c. license to use of the Company's rights in and to its service marks and trademarks in connection with the operation of one sandwich shop to be located at a site approved by the Company and the Franchisee.

4. The Company agrees to:

a. provide a training program for the operation of sandwich shops using the Company's recipes, formulas, food preparation procedures, business methods, business forms and business policies. The Franchisee shall pay all transportation, lodging and other expenses incurred in attending the program. The Franchisee must attend the training program before opening his store.

b. provide a Company Representative that the Franchisee may call upon for consultation concerning the operation of his business.

c. provide the Franchisee with a program of assistance which shall include periodic consultations with a Company Representative, publish a periodical advising of new developments and techniques in the Company's sandwich business, and grant access to home office personnel for consultations concerning the operation of his business.

5. The Franchisee agrees to:

a. begin operation of a sandwich shop within 365 days. The shop will be at a location found by the Franchisee and approved by the Company. The Company or one of its designees will lease the premises and sublet them to the Franchisee at cost. The Franchisee will then construct and equip his unit in accordance with Company specifications contained in the Operating Manual. Upon request, which shall not be unreasonably withheld, the Company will grant additional time to the Franchisee to begin operations. In all instances, the location of each unit must be approved by the Company and the Franchisee.

b. operate his business in compliance with applicable laws and governmental regulations. The Franchisee will obtain at his expense, and keep in force, any permits, licenses or other consents required for the leasing, construction or operation of his business. In addition, the

Franchisee shall operate his store in accordance with the Company's Operating Manual which may be amended from time to time as a result of experience, changes in the law or changes in the marketplace. The Franchisee shall refrain from conducting any business or selling any products other than those approved by the Company at the approved location.

c. be responsible for all costs of operating his unit including, but not limited to, advertising, taxes, insurance, food products, labor and utilities. Insurance shall include, but not be limited to, comprehensive liability insurance including products liability coverage in the minimum amount of $1,000,000. The Franchisee shall keep these policies in force for the mutual benefit of the parties. In addition, the Franchisee shall save the Company harmless from any claim of any type that arises in connection with the operation of his business.

d. refrain from engaging in any other business, directly or indirectly, during the term of this Agreement, identical with or similar to the business reasonably contemplated by this Agreement at any place except as a duly licensed franchisee of Doctor's Associates, Inc. In the event the Franchisee breaches this provision he shall pay to the Company $7,500.00 for each store opened in violation of this paragraph plus eight (8%) per cent of the gross sales of each store opened in violation of this subparagraph.

e. execute and deliver to the Company appropriate preauthorized check forms for his store's checking account prior to the opening of the sandwich shop so that the Company will be able to deposit the Royalty and Advertising Fund charges that accrue on a timely basis.

f. report his gross sales by telephone within two (2) days after the end of the business week (currently Tuesday) and submit written weekly summaries showing results of his operations by the following Saturday. If the

Franchisee fails to report his gross sales on a timely basis, the Company may estimate his sales. The Company will then deposit, into its account and the account of the Franchisee Advertising Fund, the Franchisee's preauthorized checks for the amounts due.

g. allow the Company's representatives or agents to enter his business premises during regular business hours to inspect and audit his business operations. For a period of three years, the Franchisee will keep all of the following on file at the store: cash register tapes, control sheets, weekly inventory sheets, deposit slips, bank statements and cancelled checks, sales and purchase records, business tax returns and accounting records. Also, the Franchisee hereby grants permission to the Company to examine all records of any supplier pertaining to his purchases.

h. reimburse the Company for the amount of the Royalties and Advertising Fund charges that would have been billed had his sales been reported accurately, plus interest on said amounts at the maximum legal rate in the jurisdiction in which the store is located, if it is found by the Company that the Franchisee has under-reported sales of his unit. In addition, if the amount of sales reported for any calendar year are less than ninety-eight (98%) per cent of the actual sales for that period, the Franchisee agrees to reimburse the Company for all costs of the investigation that uncovered the under-reported sales including salaries, travel, meals and lodging. In addition, the Franchisee will pay for all costs of the audit if his books and records are not produced at the time of audit provided that the Company gives five (5) days written notice of the audit prior to the scheduled date.

i. pay into the Franchisee Advertising Fund two and one-half (2½%) per cent of the gross sales of his sandwich shops. It is contemplated by the parties that the percentage payment may change in the future depending upon the prevailing market conditions and advertising requirements. However, it is agreed that no change in the percentage payment may be made without the approval of seventy-five (75%) per cent of the existing franchised units on the basis of one vote for each unit operating.

j. refrain from placing "For Sale" or similar signs at or in the general vicinity of the unit or using any words in any advertising denoting that the subject of a sale is a SUBWAY unit.

k. make prompt payment of all charges which are properly due in addition to the Royalty and Advertising Fund Payment.

6. Any relocation of the unit shall be made only upon the prior written approval of the Company. In the event the unit is relocated, the Franchisee will pay all expenses incidental to the termination of the lease and all moving expenses. If this Agreement is materially breached by the Franchisee, the Company or its designee may cancel the Sublease with the Franchisee upon such notice as is required in the Sublease.

7. The term of this Agreement shall be for a period of twenty (20) years from the date of its execution. The Franchisee shall have the option to extend the Agreement under the same terms and conditions for additional consecutive twenty (20) year periods if he gives the company written notice of his election to do so not less than one (1) year prior to the expiration of each twenty-year term.

8. a. Provided it gives the Franchisee written notice at least ten (10) days prior thereto, the Company may, at its option and without prejudice to any of its other rights or remedies provided for hereunder, terminate this Agreement if the Franchisee fails to pay any sums of money due the Company or one of its affiliates. The written notice shall specify the default and further provide that the Franchisee has ten (10) days from the date of delivery of the notice to remedy the default.

b. Provided it gives the Franchisee written notice at least ninety (90) days prior thereto, the Company may, at its option and without prejudice to any of its other rights or remedies provided for hereunder, terminate this Agreement in the following circumstances:

(1) the Franchisee does not substantially perform all of the terms and conditions of this Franchise Agreement not otherwise covered in Paragraph 8.a.;

(2) the Franchisee loses possession of the premises at which his store is located or fails to make rental payments on a timely basis;

(3) the Franchisee is guilty of any material misrepresentation in the reporting of gross sales that he is required to make to the Company. An understatement of gross sales in the amount of two (2%) per cent for a calendar year shall be deemed to be a material misrepresentation;

(4) the Franchisee makes an assignment for the benefit of his creditors or files a petition under Chapter 7 of the Bankruptcy Act;

(5) the Franchisee loses any permit or license which is a prerequisite to the operation of his unit.

The notice required under Subparagraph 8.b. shall specify the default and provide that the Franchisee has sixty (60) days in which to remedy the claimed deficiency. If the default is cured within sixty (60) days, the notice shall be void.

c. Upon termination of this Agreement, all of the Franchisee's rights hereunder shall terminate. The Franchisee shall forthwith discontinue use of all trade names, trademarks, service marks, signs, colors, structures, printed goods and forms of advertising indicative of the Company's sandwich business and return the Operating Manual to the Company. In the event of a breach of this provision, the Franchisee will be obligated to pay the Company $100.00 per day for each day he is in default.

d. In the event that the foregoing conditions under which the franchise can be terminated are violative of the laws of the State in which the Franchisee is operating his unit, the laws of that State relating to termination shall prevail.

e. In the event of a termination of the franchise, the Franchisee shall not be directly or indirectly associated as an employee, proprietor, stockholder, partner, agent or officer with or in the operation of any sandwich business within a radius of three (3) miles of an existing Company or franchised unit for a period of one (1) year. This provision also extends to locations in which a SUBWAY unit formerly existed within the previous year. In the event of a breach of this provision the Franchisee shall pay to the Company $7,500.00 for each store plus eight (8%) per cent of the gross sales of each store he is associated with within the restricted area during the one (1) year period.

9. The Franchisee's rights hereunder are transferable only as follows:

a. The Franchisee may sell his franchise and sandwich shop to a natural person, provided;

(1) the Franchisee first offers, in writing, to sell his franchised sandwich shop to the Company on the same terms and conditions as offered by a bona fide third party offeror and the Company fails to accept such offer for a period of thirty (30) days; and

(2) the purchaser has a satisfactory credit rating, is of good moral character, will comply with the Company's standard training requirements, has received the required disclosure documents in accordance with the Federal and State laws, rules and regulations and executes the then current Franchise Agreement being utilized by the Company; and

(3) all money obligations of the Franchisee to the Company and the Franchisee Advertising Fund are fully

paid and the Franchisee is not otherwise in default under this Agreement; and

(4) the Franchisee pays the Company $3,750.00 for its legal, accounting, training, and other expenses incurred in connection with the transfer.

b. The franchisee may assign his rights under this Agreement to a corporation without being relieved of any personal liability hereunder, provided:

(1) the corporation is newly organized and its activities are confined exclusively to operating the Franchisee's SUBWAY sandwich shop; and

(2) the Franchisee is, and, at all times remains, the owner of the controlling stock interest of the corporation; and

(3) the corporation agrees in writing to assume all of the Franchisee's obligations hereunder; and

(4) all stockholders of the corporation guarantee in writing the full and prompt payment and performance by the corporation of all its obligations to the Company pursuant to the assignment.

c. Upon the Franchisee's death his rights hereunder may pass to his next of kin or legatee provided such next of kin or legatee agrees in writing to assume the Franchisee's obligations hereunder and to attend the Company's next training session.

10. The parties also agree as follows:

a. The Franchisee is, and at all times during the term of this Agreement shall be, a natural person (not a corporation), an independent contractor and not an agent or employee of the Company.

b. If the Franchisee, for any reason, abandons, surrenders, or suffers revocation of all or any part of his rights and privileges under this Agreement, all such rights shall revert to the Company.

c. Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost of such a proceeding will be borne equally by the parties.

d. In the event that the Franchisee withholds any monies due under this Agreement in the absence of a Court Order, or order of an Arbitrator selected in accordance with Paragraph 10.c, permitting the withholding of monies, the Company shall be reimbursed by the Franchisee for all reasonable costs that it incurs in pursuing the collection of the withheld monies. These costs shall include but not be limited to Arbitration fees, Court costs, attorneys' fees, management preparation time, witness fees, and travel expenses incurred by the Company.

e. No waiver by the Company of any default of the Franchisee shall constitute a waiver of any other default and shall not preclude the Company from thereafter requiring strict compliance with this Agreement.

f. Should any provision of this Agreement be construed or declared to be invalid, such decision shall not affect the validity of any remaining portion which shall remain in full force and effect as if this Agreement had been executed with such invalid portion eliminated.

g. This Agreement may be transferred and assigned by the Company and shall inure to the benefit of its successors and assigns.

h. No previous course of dealing or usage in the trade not specifically set forth in this Agreement shall be admissible to explain, modify or contradict this Agreement.

i. Whenever notice is required under the terms of this Agreement, the same shall be given in writing and sent by registered or certified mail. All such notices to the Franchisee shall be addressed to the store address or his home address.

j. The Company may charge interest on all past-due accounts of the Franchisee at the maximum legal rate in the jurisdiction in which the store is located.

k. In the event any of the Franchisor's service marks or trademarks are challenged by third parties claiming infringement of alleged prior or superior rights in such marks, the Franchisor shall have the option and right to modify or discontinue use of its service marks or trademarks and adopt substitute service marks or trademarks in the Franchisee's geographical business areas and in such other areas as the Franchisor chooses. The Franchisor's liability to the Franchisee under such circumstances shall be limited to the cost of replacement of the Franchisee's signs and advertising materials in effecting such modifications, discontinuance or adoption of substitute service marks or trademarks.

l. In the event the Franchisor is required to purchase the equipment and/or leasehold improvements of the Franchisee upon termination of this Agreement pursuant to the requirements of any Federal, State or local statute, rule or regulation or any judicial determination, the purchase price shall be computed at the Franchisee's cost less depreciation and amortization based upon a five (5) year life under the straight-line method.

m. In the event that this Agreement is wrongfully terminated by the Franchisee wherein he, or a successor, continues to operate in the sandwich business, he shall be additionally liable to the Franchisor for lost royalties based upon prospective sales of the unit, actual expenses incurred by the Franchisor to re-establish a franchise in the Franchisee's market area and for applicable development costs of the Franchisor's merchandising system misappropriated by the Franchisee.

n. In the event that the Company defaults in the performance of any term or condition of the Agreement, the Franchisee shall give the Company, by registered mail or certified mail, written notice within ninety (90) days of the occurrence of the default and shall specify therein the acts or omissions constituting the default. If the Company fails to cure the default within sixty (60) days after receipt of the notice, the Franchisee's obligations to make Royalty payments thereafter shall cease until the default is cured by the Company. Any default by the Company that occurred more than ninety (90) days prior to written notice thereof shall be deemed waived by the Franchisee.

11. All terms and words used in this Agreement, regardless of the number and gender in which they are used, shall be deemed and construed to include any other number, singular or plural, and any other gender, masculine, feminine, or neuter, as the context or sense of the Agreement or any section, paragraph or clause herein may require, as if such words had been fully and properly written in the appropriate number and gender.

12. This Agreement shall be governed by and construed in accordance with the laws of the State of Connecticut and contains the entire understanding of the parties. Other than the representations contained in the Agreement, the Offering Circular and advertising materials of the Franchisor, no other representations have been made to or relied on by the Franchisee except as set forth below:

_____

_____

_____

_____

13. Each of the parties hereto acknowledges that he has read and understands this Agreement and consents to be bound by all of its terms and conditions.

Signed & Sealed in the presence of:

DOCTOR'S ASSOCIATES, INC.

by /s/ Donald Fertman, Jr.
Duly Authorized

/s/ Paul S. Casarotto
Franchisee
PAUL S. CASAROTTO

[Filed in Montana Eighth Judicial District Court]

AMERICAN ARBITRATION ASSOCIATION

MEDIATION Please consult the applicable mediation rules regarding mediation procedures. If you want the AAA to contact the other party and attempt to arrange a mediation, please check this box. ☐

COMMERCIAL ARBITRATION RULES

DEMAND FOR ARBITRATION

Date: January 25, 1993

To:

Name Paul Casarotto

Address c/o Henry R. Crane, Tawney & Dayton, 607 SW Higgins Ave., P.O. Box 3658

City and State Missoula, MT 59806-3658

Telephone (406) 542-5000

Name of Representative Henry R. Crane, Tawney & Dayton

Representative's Address 607 SW Higgins Ave., P.O. Box 3658

City and State Missoula, MT 59806-3658

Telephone (406) 542-5000

The named claimant, a party to an arbitration agreement contained in a written contract, dated 4/25/88, providing for arbitration under the Commercial Arbitration Rules, hereby demands arbitration thereunder.

(Attach the arbitration clause or quote it hereunder.)

Hearing Locale Requested: Bridgeport, CT

Claim or Relief Sought: (amount, if any)

Type of Business: Claimant Franchisor Respondent Franchisee

Hearing Locale Requested: Bridgeport, CT

You are hereby notified that copies of our arbitration agreement and of this demand are being filed with the American Arbitration Association at its Hartford, CT office, with the request that it commence the administration of the arbitration. Under the rules, you may file an answering statement within ten days after notice from the administrator.

Signed Alan G. Schwartz Title Attorney

Name of Claimant Doctor's Associates, Inc.

Address (to be used in connection with this case) 3201 Commercial Blvd., Suite #116

City and State Ft. Lauderdale, FL 33309

Telephone (203) 877-4281 Fax (203) 876-6690

Name of Representative Alan G. Schwartz, Wiggin & Dana

Representative's Address One Century Tower

City and State New Haven, CT 06508-1832

Telephone (203) 498-4332 Fax (203) 782-2889

To institute proceedings, please send three copies of this demand with the administrative fee, as provided in the rules, to the AAA. Send the original demand to the respondent.

[Attached copy of arbitration clause.]

c. Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost of such a proceeding will be borne equally by the parties.

[Attached copy of Nature of Dispute.]

Doctor's Associates, Inc. (DAI), hereby demands arbitration of the claims of a lawsuit brought in Montana state court by Paul Casarotto. DAI will be filing a motion to dismiss or in the alternative to stay the proceedings pending arbitration. Pursuant to a franchise agreement to which DAI and Paul Casarotto are parties, the claims are arbitrable.

MONTANA EIGHTH JUDICIAL DISTRICT COURT
CASCADE COUNTY

Cause No. BDV-92-860

PAUL CASAROTTO and PAMELA CASAROTTO,
Plaintiffs
v.

DANIEL L. and DEB HUDSON,
D&D SUBWAY CORPORATION, NICK LOMBARDI,
and DOCTOR'S ASSOCIATES, INC.,
Defendants

STATE OF CONNECTICUT)
) ss. Milford, Jan. 28, 1993
COUNTY OF NEW HAVEN)

AFFIDAVIT

I, LEONARD H. AXELROD, being duly sworn do hereby depose and say as follows:

1. My name is Leonard H. Axelrod and I reside at 27 Sherman Lane, Hamden, Connecticut. I am over the age of 18 years, understand the obligation of an oath, and have personal knowledge of the facts set forth herein.

2. I am Vice President of Doctor's Associates, Inc., the national franchisor of Subway sandwich shops.

3. Doctor's Associates, Inc. ("DAI") is a corporation organized and existing under the laws of the State of Florida and has been a Florida corporation since June of 1991.

4. The Florida address and the principal place of business for DAI is 3201 Commercial Boulevard, Suite #116, Ft. Lauderdale, FL 33309.

5. Before July 1991, DAI was a corporation organized under the laws of the State of Connecticut, with a principal place of business at 325 Bic Drive, Milford, CT 06460. On July 1, 1991, DAI of Florida merged with DAI of Connecticut, leaving DAI of Florida as the surviving corporation.

6. DAI has sold a total of over 8500 Subway franchises in the United States and estimates that there are approximately 7,400 stores in operation worldwide.

7. A franchise agreement to operate a Subway restaraunt contemplates a substantial amount of continuing interstate economic activity.

8. The franchise agreement essentially grants a franchisee a license to use nationally-known and federally-registered Subway trademarks and affords franchisees access to the benefits of national marketing performed by and on behalf of all franchisees.

9. A franchise agreement does not specify a particular location for a restaurant other than to designate the state in which the franchisee shall operate the restaurant.

10. In consideration for the license to use nationally-known trademarks, franchisees agree to pay a franchise fee and make weekly royalty payments to DAI based on a percentage of weekly gross sales.

11. To facilitate this procedure, franchisees agree to execute and deliver to DAI pre-authorized check forms to allow DAI to withdraw weekly royalties.

12. As well, franchisees agree to report weekly sales by telephone to Franchise World Headquarters, Inc., DAI's affiliate in Connecticut, and make available for DAI's inspection all business records of each store.

13. Franchisees also agree to make regular payments into a Franchisee Advertising Fund, whose board is composed of Subway franchisees, and that conducts a national marketing campaign on behalf of all franchisees.

14. Before a store is permitted to open, a franchisee is required to attend training by DAI in Connecticut to learn how to operate a Subway restaurant.

15. Under DAI's franchise agreements, franchisees maintain significant contact with DAI's offices in Florida and Connecticut and, in turn, benefit continually from DAI's expertise in franchising and national exposure.

16. Paul Casarotto, plaintiff in this action, entered into a franchise agreement with DAI on or about April 25, 1988. The Agreement was signed in Connecticut on behalf of DAI by Donald Fertman.

17. Under the terms of the Agreement, Casarotto agreed to attend training in Connecticut, report weekly sales to DAI in Connecticut, make weekly royalty payments to Connecticut, and make regular payments into the Franchisee Advertising Fund.

18. The Agreement permitted Casarotto to operate a Subway sandwich shop in Montana.

19. All parties to the Agreement agreed that any claims arising out of the Agreement would be arbitrated in accordance with ¶ 10(c) in Bridgeport, Connecticut.

20. Pursuant to the terms of the Agreements, Casarotto was required to maintain a substantial ongoing relationship with DAI in Milford, Connecticut and Ft. Lauderdale, Florida.

/s/ Leonard H. Axelrod
LEONARD H. AXELROD

[Jurat Omitted]

MONTANA EIGHTH JUDICIAL DISTRICT COURT
CASCADE COUNTY

Cause No. BDV-92-860

PAUL CASAROTTO and PAMELA CASAROTTO,
Plaintiffs,

v.

DANIEL L. and DEB HUDSON,
D&D SUBWAY CORPORATION, NICK LOMBARDI,
and DOCTOR'S ASSOCIATES, INC.,
Defendants.

STATE OF DELAWARE)
) ss.
COUNTY OF KENT)

AFFIDAVIT OF PAUL CASAROTTO

I, PAUL CASAROTTO, being duly sworn do hereby depose and say as follows:

1. I am one of the Plaintiffs in the above-entitled action and I am over the age of eighteen years.

2. In the early part of 1988, I contacted Doctor's Associates ("Doctors") in order to find out more about becoming a Subway franchisee.

3. That I received a return call from someone in Doctors concerning franchise purchases.

4. I was considering becoming a Subway franchisee in Great Falls, Montana.

5. I communicated telephonically with Doctors for a period of time during which Doctors explained the required process for becoming a franchisee.

6. That Doctors sent several documents to me at my home in Great Falls, Montana, including the Subway franchise agreement ("agreement").

7. Doctors told me that the agreement was a standard agreement and had to be signed as is, with no changes or modifications.

8. I read the agreement over before I signed it, however, no one ever told or explained to me that the agreement contained an arbitration clause or that the agreement was to be interpreted according to the laws of the State of Connecticut.

9. I signed the agreement on or about April 25, 1988 while I was visiting my mother in Albany, New York. This was the first standardized franchise agreement that I have ever signed.

10. I did not know that I was giving up my right to sue Doctors in Montana until my attorney, Robert Drummond told me in early 1992.

11. I did not have an attorney review the agreement for me prior to signing it.

12. The first time I spent any time with Doctor's personnel was in June, 1988, when I went to Connecticut for franchise training.

/s/ Paul Casarotto
PAUL CASAROTTO

[Jurat Omitted]

(6)

No. 95-559

IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,
Petitioners,

v.

PAUL CASAROTTO, ET UX.,
Respondents.

On Writ of Certiorari to the Supreme Court of Montana

BRIEF FOR PETITIONERS

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QUESTION PRESENTED

Whether Section 2 of the Federal Arbitration Act (9 U.S.C. § 2)—which makes written agreements to arbitrate "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract"—preempts a state law that makes agreements to arbitrate, but not other agreements, unenforceable unless a specific notice of the arbitration agreement is placed on the first page of the contract.

STATEMENT PURSUANT TO RULE 24.1(b)

Daniel L. Hudson, Deb Hudson, and D&D Subway Corporation are parties to the proceedings in the Montana Eighth Judicial District Court. They were not parties to the appeal in the Supreme Court of Montana and are omitted from the caption in this Court.

The list required by Rule 29.6 can be found on page ii of the Petition for a Writ of Certiorari.

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IN THE
Supreme Court of the United States
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No. 95-559

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,
Petitioners,
v.
PAUL CASAROTTO, ET UX.,
Respondents.

On Writ of Certiorari to the Supreme Court of Montana

BRIEF FOR PETITIONERS

OPINIONS BELOW

The opinion of the Supreme Court of Montana is reported at 901 P.2d 596. The prior opinion of the Montana Supreme Court in this case is reported at 268 Mont. 369, 886 P.2d 931. Both opinions are reprinted in full in the Joint Appendix at 48-59 and 12-47, respectively. The earlier opinion was vacated by this Court in an order reported at 115 S. Ct. 2552. The order of the Montana Eighth Judicial District Court is not reported but is reprinted in full in the Joint Appendix at 10-11.

JURISDICTION

The Supreme Court of Montana entered judgment on August 31, 1995. The petition for a writ of certiorari was filed on October 2, 1995, and was granted on January 5, 1996. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257(a).

STATUTORY PROVISIONS INVOLVED

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2, provides:

> **Validity, irrevocability, and enforcement of agreements to arbitrate**
>
> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Section 27-5-114(4), Montana Code Annotated, provides:

> Notice that a contract is subject to arbitration pursuant to this chapter shall be typed in underlined capital letters on the first page of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration.

The full text of Section 27-5-114, which governs the validity of arbitration agreements under Montana law, is set out in an appendix to this brief.

STATEMENT

This case arises from the refusal of the Montana Supreme Court to enforce an agreement by the parties to arbitrate their disputes. The court did not reach that result because the parties had failed to comply with the requirements under federal law for enforcing an agreement to arbitrate. Quite the opposite. It is undisputed that the parties' agreement to arbitrate met every requirement of Section 2 of the Federal Arbitration Act ("FAA"), 9 U.S.C. § 2, which makes written arbitration

agreements involving interstate commerce "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." Nevertheless, the Montana Supreme Court held that the agreement was unenforceable because it did not comply with a state law—applicable only to arbitration agreements—that invalidates agreements to arbitrate unless notice that a contract is subject to arbitration is typed in underlined capital letters on the first page of the contract. *See* Mont. Code Ann. § 27-5-114(4) (1995). In so doing, the court rejected Petitioners' argument that the notice requirement is preempted by Section 2 of the FAA. App. 21-28.

Petitioner Doctor's Associates, Inc. ("DAI") is the national and international franchisor of "Subway" sandwich shops. App. 83; *see* App. 10. At the time of this dispute, DAI had sold a total of over 8,500 Subway franchises throughout the United States. App. 84. Today, Subway has sold more than 10,000 franchises nationwide. Petitioner Nick Lombardi is DAI's Development Agent in Montana. *See* App. 13. During the events in question, DAI was a Connecticut corporation with its principal place of business in Milford, Connecticut. App. 84.

In April 1988, DAI entered into a franchise agreement with Paul Casarotto, which permitted Casarotto to open a Subway sandwich shop in Montana. App. 64-78.[1] The franchise agreement was a standard contract that DAI used with all its franchisees throughout the United States. The agreement authorized Casarotto to operate a Subway sandwich shop and granted him a license to use DAI's federally-registered "SUBWAY" trademarks and service marks. App. 65. It also contained an express arbitration clause providing that "[a]ny controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accord-

[1] Two months later, he traveled to DAI's headquarters in Connecticut to attend training sessions for new franchisees. App. 87.

ance with the Commercial Arbitration Rules of the American Arbitration Association." App. 75.[2] Another section of the franchise agreement stated that "[t]his Agreement shall be governed by and construed in accordance with the laws of the State of Connecticut." App. 77. Just above the signature block, the agreement provided: "Each of the parties hereto acknowledges that he has read and understands this Agreement and consents to be bound by all of its terms and conditions." App. 78.[3]

When a dispute later arose, Casarotto ignored the agreement to arbitrate and filed an action against DAI,

[2] The full text of the arbitration clause (App. 75) provides as follows:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost of such a proceeding will be borne equally by the parties.

[3] Paul Casarotto filed an affidavit in the Montana state district court, averring that "I read the agreement over before I signed it," although he goes on to state that "no one ever told or explained to me that the agreement contained an arbitration clause or that the agreement was to be interpreted according to the laws of the State of Connecticut." App. 87. DAI also provided Casarotto a detailed franchise offering circular that contained the following statement on the first page: "READ ALL OF YOUR CONTRACT CAREFULLY. BUYING FRANCHISE [sic] IS A COMPLICATED INVESTMENT. TAKE YOUR TIME TO DECIDE. IF POSSIBLE, SHOW YOUR CONTRACT AND THIS INFORMATION TO AN ADVISOR, SUCH AS A LAWYER OR AN ACCOUNTANT." App. 62. The offering circular stated that the franchise agreement provided for binding arbitration of any claim of breach of the agreement in accordance with the Commercial Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut, with costs to be borne equally by the parties. App. 63.

Lombardi and others in the Montana Eighth Judicial District Court, Cascade County.[4] The suit alleged that Casarotto had entered into the franchise agreement and had opened a Subway store on the west side of Great Falls in reliance on representations of DAI and Lombardi that he would have an exclusive right to open another store in a different part of town when that location became available. Casarotto claimed that, contrary to his understanding with DAI and Lombardi, they had awarded the other location to another franchisee and that they had interfered with efforts to sell his store. The complaint asserted state-law contract, tort and statutory claims against DAI and Lombardi. Amended Verified Complaint, filed Nov. 4, 1992; *see* App. 13-14.

Citing the arbitration provisions in the franchise agreement, DAI and Lombardi moved in the state district court to dismiss or stay the lawsuit pending arbitration. They argued that Section 2 of the FAA required arbitration of the claims; that the FAA preempted state laws that impede enforcement of any agreement to arbitrate; and that, to the extent state law was even relevant, Montana law was inapplicable because the contract specified the parties' choice of Connecticut law, under which the agreement to arbitrate was enforceable. *See* App. 15. DAI also filed with the American Arbitration Association a Demand for Arbitration of Casarotto's claims. App. 79-82; *see* App. 11.

[4] The suit named Paul Casarotto and his wife, Pamela Casarotto, as plaintiffs. Paul and Pamela Casarotto asserted claims against defendants other than DAI and Lombardi with whom they did not have an arbitration agreement. Those claims were not the subject of the opinions and orders below. With respect to the claims asserted against DAI and against Lombardi as DAI's Development Agent, only Paul Casarotto had entered into the franchise agreement, and it is clear from the complaint that only he, and not his wife, is asserting claims against DAI and Lombardi. *See* Amended Verified Complaint, filed Nov. 4, 1992, Counts 9, 11 and 13. However, the opinions below referred to the plaintiffs in the plural and treated both plaintiffs alike.

The Montana district court granted Petitioners' motion to stay the lawsuit as against them pending arbitration. The court found that the parties' franchise agreement involved interstate commerce within the meaning of Section 2, that the agreement's arbitration clause encompassed the claims against DAI and Lombardi, and that DAI had properly demanded arbitration of those claims. Accordingly, the court stayed the litigation against DAI and Lombardi "until the arbitration has been had in accordance with the terms of the arbitration agreement." App. 10-11.

The Montana Supreme Court reversed. The court did not question that the arbitration agreement met all the requirements of federal law. The court also left undisturbed the district court's rulings that the agreement involved interstate commerce and covered the claims against DAI and Lombardi, and that DAI's arbitration demand complied with the agreement. The Montana Supreme Court nonetheless refused to enforce the arbitration agreement because it did not comply with a provision of Montana's arbitration act, *see* Mont. Code Ann. § 27-5-114(4) (1995), which makes an arbitration agreement unenforceable unless the contract containing that agreement also contains a notice, in underlined capital letters on its first page, that it is subject to arbitration. The Montana statute, by its terms and as interpreted by the Montana Supreme Court (App. 20-21), affects the enforceability of arbitration agreements but not other types of contracts.

The decision of the Montana Supreme Court not to enforce the agreement to arbitrate proceeded in several steps. First, before reaching the question whether the FAA preempts state arbitration law, the court determined that it would apply Montana law to the franchise agreement. Although the parties had explicitly provided in their contract that it would be construed in accordance with Connecticut law, the Montana Supreme Court rejected that selection and ruled that Montana law governed,

reasoning that the state's arbitration notice statute (which has no counterpart in Connecticut law) embodied a fundamental public policy that could not be thwarted by the parties' choice of a different state's law.[5] According to the court, the public policy of requiring notice of a contractual arbitration clause reflected state legislative concerns that Montanans receive sufficient notice before agreeing to a dispute resolution method that was potentially inconvenient, expensive and devoid of the procedural safeguards of a judicial proceeding. App. 20-21.

Having decided that the parties' contract was governed by Montana law, and because the contract did not contain the notice required by Montana law, the Montana Supreme Court next considered whether the FAA preempted Montana's arbitration notice statute. The court acknowledged decisions of this Court holding that Section 2 of the FAA created federal substantive law binding on the states on the issue of the enforceability of arbitration agreements, App. 21-23, but interpreted *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), as retreating from earlier authority by allowing courts to deny enforcement of arbitration agreements based on state arbitration laws so long as those laws do not "undermine the goals and policies of the FAA." App. 24-26. The court declined to follow decisions by several federal courts of appeals and one state supreme court that had held similar state notice requirements preempted by the FAA, because those decisions either preceded *Volt* or, according to the Montana court, contained little or no reference to *Volt*. App. 27.

The Montana court thus concluded that "we must rely on our own analysis of whether Montana's notice require-

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[5] Connecticut law is virtually identical to the FAA in the conditions it imposes for enforcing agreements to arbitrate. *See* Conn. Gen. Stat. § 52-408 (1995).

ment undermines the goals and policies of the FAA." App. 27. The court observed that a notice statute ensuring that parties had "knowingly" entered into an arbitration agreement was consistent with the policies underlying the FAA, and therefore was not preempted, because "the FAA does not require parties to arbitrate when they have not agreed to do so." App. 27. The court thus held that the agreement to arbitrate, but no other term of the franchise agreement, was unenforceable.[6]

Last Term, this Court vacated the judgment of the Montana Supreme Court and remanded the case for further consideration in light of *Allied-Bruce Terminix Companies v. Dobson*, 115 S. Ct. 834 (1995), which had been decided after the Montana court rendered its decision. *Doctor's Associates, Inc. v. Casarotto*, 115 S. Ct. 2552 (1995). The Montana Supreme Court ignored Petitioners' request to brief and argue the issues on remand, App. 57 (Gray, J., dissenting), and, on August 31, 1995, it "reaffirm[ed] and reinstate[d]" the December 1994 opinion that this Court had vacated. App. 54.

In its decision on remand, the Montana Supreme Court first summarized its prior opinion, emphasizing again that its decision was based on an analysis of *Volt* that preemption is determined by whether the notice statute undermines the goals and policies of the FAA. App. 57. The court then observed that, because this case did not involve a "state law which made arbitration agreements invalid and unenforceable," and because the parties' agreement indisputably involved interstate commerce, "we can find nothing in the [*Terminix*] decision which relates to the issues presented to this Court in this case." App. 53. In

[6] The author of the court's opinion also wrote separately to express his "personal observation" that federal appellate judges had unnecessarily and inappropriately deprived individuals of access to a system of justice available only in the courts. App. 29-33. Three of the seven Justices on the Montana Supreme Court dissented from the court's opinion. App. 34-47.

particular, the court saw nothing in *Terminix* that required it to modify its analysis of *Volt* "that state law is only preempted to the extent that it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" App. 54 (quoting *Volt*, 489 U.S. at 477).

Chastising the majority for what they believed was an "arrogant and cavalier approach to this important case on remand from the United States Supreme Court," three of the court's seven Justices dissented on the basis that the majority had misread *Volt* and that *Terminix* had reaffirmed the supremacy of the FAA on the issue of enforceability of agreements to arbitrate. App. 57-58. The dissent took sharp exception to the majority's rush to decision without even the benefit of briefs or argument, and it concluded that "one must assume that the Court is simply unwilling to consider any analysis that would require a change in the result it remains determined to reach." App. 57.

SUMMARY OF ARGUMENT

Section 2 of the Federal Arbitration Act provides that written arbitration agreements are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of *any* contract." 9 U.S.C. § 2 (emphasis added). There is no question here that the parties agreed to arbitrate any disputes between them and no question that the agreement, which involved interstate commerce, is within the bounds of Section 2. Nevertheless, the Montana Supreme Court refused to enforce the parties' arbitration agreement for one, and only one, reason: failure to comply with a state statute requiring that notice of an agreement to arbitrate (but no other contractual term) be typed in underlined capital letters on the first page of a contract. The court thus applied Montana's public policy that was admittedly suspicious of arbitration to prohibit enforcement of the arbitration pro-

vision, but no other term, of a binding and lawful franchise agreement.

This decision is directly at odds both with the plain language of Section 2 and with the teachings of numerous decisions of this Court construing that language. Section 2 plainly commands, as a matter of federal law, that an arbitration agreement involving interstate commerce be enforced, subject to only one limitation: "save upon such grounds as exist . . . for the revocation of any contract." 9 U.S.C. § 2. This broad principle of enforceability embodied in Section 2 "is [not] subject to *any* additional limitations under state law." *Southland Corp. v. Keating*, 465 U.S. 1, 11 (1984) (emphasis added). Moreover, this Court has repeatedly read the language of Section 2—most recently in *Terminix*—to prohibit a state from singling out agreements to arbitrate and placing them on a different "footing" from other contracts. *See Terminix*, 115 S. Ct. at 838-39, 843; *Perry v. Thomas*, 482 U.S. 483, 489-91 & 492 n.9 (1987); *Southland*, 465 U.S. at 10-16; *Moses H. Cone Memorial Hosp. v. Mercury Constr. Co.*, 460 U.S. 1, 24 (1983).

Yet Montana has done precisely what federal law says it may not do—impose upon arbitration agreements conditions to enforceability that do not apply to all contracts. Although the Montana Supreme Court purported to find authority for that action in *Volt*, that decision does not permit state courts to override the wishes of the contracting parties and refuse to enforce arbitration agreements on state-law grounds that are inapplicable to other types of agreements. *See, e.g., Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1215-16 (1995); *Terminix*, 115 S. Ct. at 843; *see also Volt*, 489 U.S. at 478-79. To the contrary, *Volt* makes resoundingly clear that the wishes of the parties, not any contrary wishes of state officials or judges, are controlling. Accordingly, consistent with this Court's long line of decisions construing Section 2, every federal court of appeals and state supreme court that

has considered this issue other than the Montana court, both before and after *Volt*, has held that the FAA preempts state laws conditioning enforcement of arbitration agreements on compliance with notice requirements that apply to arbitration agreements alone. *See infra* note 8.

Were the Court now to ignore the clear language of Section 2 and retreat from its own consistent construction of that language, it would effect an immediate and sweeping change in the national policy favoring arbitration—from uniform enforcement of arbitration agreements throughout the United States, to endless questions about enforceability (and inevitably contradictory answers) depending on which state's law applies and whether that state has chosen to impose conditions on enforceability that do not apply to other contracts. This concern over "permit[ting] states to override the declared policy requiring enforcement of arbitration agreements," *Southland*, 465 U.S. at 17 n.11, is not hypothetical. In addition to Montana, at least nine states—most recently, California—have enacted arbitration laws that deny enforcement of arbitration agreements solely on the basis of the parties' failure to include a specified form of notice (which differs from state to state) that their contract is subject to arbitration. *See infra* Part II. More generally, numerous states have placed a variety of conditions on enforcement of agreements to arbitrate that do not apply to contracts generally. *See id.* Taken together, these state laws stand as a direct impediment to achieving the national uniformity contemplated by Section 2, leaving those like DAI, who transact business in multiple states, subject to the vagaries of differing, even inconsistent, state arbitration laws, all contrary to Congress's express intent in enacting the FAA. *Southland*, 465 U.S. at 16.

ARGUMENT

I. THE FEDERAL ARBITRATION ACT PREEMPTS MONTANA'S STATUTORY RESTRICTION ON ENFORCEMENT OF ARBITRATION AGREEMENTS.

The question presented is straightforward. May Montana refuse to enforce an otherwise valid agreement to arbitrate because it does not comply with state notice requirements applicable to arbitration agreements but not to other types of agreements? The plain language of Section 2, as well as this Court's consistent reading of that language, make unmistakably clear that Montana may not. Section 2 expressly and directly preempts the application of Montana's arbitration notice statute, Mont. Code Ann. § 27-5-114(4) (1995), to agreements involving interstate commerce.

A. Montana's Arbitration Notice Requirement Places Montana Law in Direct Conflict With Federal Law.

Congress enacted the FAA in order to "revers[e] centuries of judicial hostility to arbitration agreements," *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 510-11 (1974), by "plac[ing] arbitration agreements 'upon the same footing as other contracts.'" *Id.* (quoting H.R. Rep. No. 96, 68th Cong., 1st Sess. 1, 2 (1924)); *see Volt*, 489 U.S. at 474; *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991). In order to accomplish this overarching goal and thereby promote the "federal policy favoring arbitration," Congress "create[d] a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act." *Moses H. Cone Memorial Hosp. v. Mercury Constr. Co.*, 460 U.S. 1, 24 (1983); *see Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625 (1985). For transactions within its scope, the FAA requires courts "rigorously [to] enforce agreements to arbitrate." *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221 (1985); *see Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987). That obligation is binding upon federal and state courts alike. *Terminix*, 115 S. Ct. at 838-39; *Southland*, 465 U.S. at 15.

The answer to the question presented begins, of course, in the language of the FAA itself. *See Shearson/American Express*, 482 U.S. at 225. Section 2 is the "primary substantive provision" of the Act. *Gilmer*, 500 U.S. at 24. It sets forth "a congressional declaration of a liberal federal policy favoring arbitration agreements," *Moses H. Cone*, 460 U.S. at 24, and expresses Congress's intent "to mandate enforcement of all covered arbitration agreements." *Id.* at 26 n.34.

The language of Section 2 is unequivocal. A written agreement to arbitrate in any contract involving an interstate transaction is "valid, irrevocable, and enforceable" as a matter of federal law. 9 U.S.C. § 2. To that broad declaration of congressional policy confirming the validity, and requiring the enforcement, of arbitration agreements, Section 2 provides only one explicit, and explicitly limited, exception: agreements to arbitrate may be deemed unenforceable only "upon such grounds as exist at law or in equity for the revocation of *any* contract." *Id.* (emphasis added). As a matter of simple English, therefore, Section 2 permits courts to apply state laws applicable to contracts generally, but not state laws singling out arbitration agreements for disfavored treatment. *Terminix*, 115 S. Ct. at 843; *see Southland*, 465 U.S. at 16.

The Court has repeatedly confirmed this reading of Section 2. Thus, in reviewing the text of Section 2 in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), this Court could "discern only two limitations on the enforceability of arbitration provisions governed by the Federal Arbitration Act: they must be part of a written maritime contract or a contract 'evidencing a transaction involving commerce' and such clauses may be revoked upon 'grounds as exist at law or in equity for the revocation

of any contract.'" *Id.* at 10-11 (footnote omitted). Having set out what the language of the FAA distinctly commands, the Court could "see nothing in the Act indicating that the broad principle of enforceability is subject to *any* additional limitations under state law." *Id.* at 11 (emphasis added); *see id.* at 10 ("Congress . . . withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration").

Accordingly, the Court held that a state franchise law requiring judicial consideration of disputes governed by the arbitration clause of the parties' franchise agreement "directly conflicts with § 2 of the Federal Arbitration Act and violates the Supremacy Clause." *Id.* at 10. The conflict was "direct" because the defense to arbitration found in California's franchise law was "not a ground that exists at law or in equity 'for the revocation of *any* contract,'" *id.* at 16 n.11, but rather was "a ground that exists for the revocation of arbitration provisions in contracts subject to" the state law. *Id.* California's law, therefore, failed to place arbitration agreements "'upon the same footing as other contracts, where it belongs.'" *Id.* at 16 (internal quotation marks and citation omitted); *see id.* at 17 n.11.[7]

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[7] The holding of *Southland* is especially applicable here. Like this case, *Southland* involved a national franchisor, whose standard franchise agreement required all disputes arising out of the agreement to be settled by arbitration in accordance with the rules of the American Arbitration Association. *See Southland*, 465 U.S. at 3-4. The *Southland* franchisees sued in state court alleging misrepresentations (*see id.* at 4), and in both cases, the state courts refused to enforce an agreement to arbitrate out of deference to a state statute embodying a public policy suspicious of arbitration in the particular circumstances presented. *See id.* at 20-21 (Stevens, J., dissenting in part). Moreover, *Southland* and this case raise the same generic legal issue: whether a state law, "which invalidates certain arbitration agreements covered by the Federal Arbitration Act, violates the Supremacy Clause." *Id.* at 3.

In *Perry v. Thomas*, 482 U.S. 483 (1987), the Court again emphasized that the text of Section 2 is the *only* source of limitations on the enforceability of arbitration agreements involving interstate commerce: "An agreement to arbitrate is valid, irrevocable, and enforceable, *as a matter of federal law*, save upon such grounds as exist at law or in equity for the revocation of *any* contract." *Id.* at 492 n.9 (emphasis in original; citations and internal quotation marks omitted). By the express terms of that sole limitation on enforceability, state law, whether of legislative or judicial origin, is applicable only if that law governs the validity, revocability, and enforceability of contracts generally. *Id.* at 493 n.9. As this Court explained, "A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement of § 2." *Id.* Therefore, the Court instructed, under Section 2

> [a] court may not, then, in assessing the rights of litigants to enforce an arbitration agreement, construe that agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law. Nor may a court rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what we hold today the state legislature cannot.

Id.; *see Shearson/American Express*, 482 U.S. at 226.

Just last Term in *Allied-Bruce Terminix Companies v. Dobson*, 115 S. Ct. 834 (1995), this Court reaffirmed the principles established in *Southland* and *Perry*. It is true, as the Montana Supreme Court noted, that much of the opinion in *Terminix* is devoted to construing the interstate commerce language of Section 2, which is not at issue here. But *Terminix* also again made clear that Section 2 preempts state laws that single out arbitration agreements for unfavorable treatment. This Court thus restated its longstanding interpretation of Section 2:

"States may not . . . decide that a contract is fair enough to enforce its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause." *Terminix*, 115 S. Ct. at 843. In the clearest possible terms, the Court declared that the FAA "*makes any such state policy unlawful*, for that kind of policy would place arbitration clauses on an unequal 'footing,' directly contrary to the Act's language and Congress's intent." *Id.* (emphasis added).[8]

Both the FAA itself and the cases of this Court construing it thus establish that Section 2 directly preempts

[8] While the Montana Supreme Court saw nothing in *Terminix* relevant to this case, Justice O'Connor, in her concurrence in *Terminix*, recognized that the effect of the decision in *Terminix* would be to preempt statutes identical to the Montana notice statute:

> The reading of § 2 adopted today will displace many state statutes carefully calibrated to protect consumers, see, *e.g.*, Mont. Code Ann. § 27-5-114(2)(b) (1993) (refusing to enforce arbitration clauses in consumer contracts where the consideration is $5,000 or less), and state procedural requirements aimed at ensuring knowing and voluntary consent, see, *e.g.*, S.C. Code Ann. § 15-48-10(a) (Supp. 1993) (*requiring that notice of arbitration provision be prominently placed on first page of contract*).

115 S. Ct. at 843 (emphasis added).

Except for the Montana Supreme Court, all federal courts of appeals and state supreme courts that have considered whether the FAA preempts a state arbitration notice requirement have found preemption. *See David L. Threlkeld & Co. v. Metallgesellschaft Ltd.*, 923 F.2d 245, 249-50 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991); *Securities Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1120 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990); *Webb v. R. Rowland & Co.*, 800 F.2d 803, 806-07 (8th Cir. 1986); *Collins Radio Co. v. Ex-Cell-O Corp.*, 467 F.2d 995, 997-99 (8th Cir. 1972); *Bunge Corp. v. Perryville Feed & Produce, Inc.*, 685 S.W.2d 837, 839 (Mo. 1985) (en banc); *see also King v. Postal Annex, Inc.*, No. CV-94-011-GF, slip op. at 4-6 & 6 n.5 (D. Mont. Dec. 14, 1995) (concluding that Montana Supreme Court's decision in *Casarotto* "is without merit"); *Snap-On Tools Corp. v. Vetter*, 838 F. Supp. 468, 472 (D. Mont. 1993) (Montana notice requirement preempted by FAA).

any state law that singles out arbitration agreements for disfavored treatment. Montana's law does precisely that, however. For it plainly singles out and subjects arbitration agreements to an "additional limitation[] under state law" (*Southland*, 465 U.S. at 11) that is not applicable to other contractual provisions. By its terms and as interpreted by the Montana Supreme Court, Montana's statute does not affect the validity of contracts generally; it limits enforcement only of arbitration agreements as part of a state policy disfavoring arbitration.[9] As the Montana Supreme Court candidly acknowledged, the notice statute was borne of a legislative mistrust of "a procedure as potentially inconvenient, expensive, and devoid of procedural safeguards as the one provided for by the rules of the American Arbitration Association." App. 21.[10]

[9] The notice statute, Mont. Code Ann. § 27-5-114(4) (1995), is part of the Montana Uniform Arbitration Act. However, it is a deviation from the Uniform Arbitration Act (1955), 7 U.L.A. 1 (West 1985 & Supp. 1995), which contains no notice requirement. Montana has enacted other provisions refusing to enforce arbitration in certain types of contracts, set forth in the appendix to this brief, which also are deviations from the uniform act. Montana enacted its arbitration act in 1985 in the wake of the Court's decision in *Southland*.

[10] This same anti-arbitration policy caused the Montana Supreme Court to make a second, related error: its decision to apply Montana law despite the parties' explicit contractual choice of Connecticut law. The Montana court relied on a state policy hostile to arbitration as the reason for applying Montana law to the agreement under conflict-of-laws principles and then proceeding to invalidate the agreement under that same policy. If it were not for the arbitration notice requirement that Petitioners argue is preempted by Section 2, the court below would not have reached its conclusion that the Connecticut law chosen by the parties (which has no special notice requirement) was offensive to Montana's public policy. App. 20-21. *Cf. Mastrobuono*, 115 S. Ct. at 1219 (reading choice-of-law clause in manner intended to give effect to parties' agreement to arbitrate); *Volt*, 489 U.S. at 475-76 (due regard must be given to federal policy favoring arbitration when applying general state-law principles); *id.* at 479 (parties' expectations should be enforced where it would not do "violence

In short, Montana law embodies precisely the type of focused hostility toward arbitration that Congress sought to overcome when it enacted the FAA. *Terminix*, 115 S. Ct. at 838. The Montana Supreme Court claims that the Montana notice provision is not hostile to arbitration because it does not invalidate all arbitration agreements as did the Alabama law in *Terminix*, but "simply" ensures that Montanans knowingly enter into arbitration agreements. App. 53. Section 2, however, expresses Congress's considered judgment that in light of historical antipathy toward arbitration, permitting such differential state-law treatment of arbitration agreements would "wholly eviscerate congressional intent to place arbitration agreements upon the same footing as other contracts." *Southland*, 465 U.S. at 17 n.11. This Court has consistently held, therefore, that any state policy of offering special protection to signatories of arbitration agreements that is not accorded contracts generally is directly contrary to the mandates of Section 2 and the policies underlying the FAA. *Southland*, 465 U.S. at 16 n.11; *see Perry*, 482 U.S. at 493 n.9. Section 2 requires enforcement of arbitration agreements within its scope, as the agreement here assuredly is, "notwithstanding *any* state substantive or procedural policies to the contrary." *Moses H. Cone*, 460 U.S. at 24 (emphasis added).

This is not to say, of course, that Montana cannot protect its citizens from the effects of contractual overreaching. Congress did not disable the states from applying general principles of unconscionability to arbitration agreements. *Terminix*, 115 S. Ct. at 843; *see Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 483-84 (1989). But a state may not *single out* arbitration agreements for special treatment out of a con-

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to the policies behind the FAA"). In any event, because the Montana statute is preempted by Section 2, it is not necessary for this Court to reach out and decide whether the Montana Supreme Court's conflict-of-laws analysis was independently flawed by its dependence on a statute evidencing hostility toward arbitration.

cern that those agreements in particular may be the product of unequal bargaining power. *Terminix*, 115 S. Ct. at 843. Thus, "[a]bsent a well-founded claim that an arbitration agreement resulted from the sort of fraud or excessive economic power that 'would provide grounds for "the revocation of any contract,"' " the FAA mandates enforcement of the arbitration agreement. *Shearson/American Express*, 482 U.S. at 226 (quoting *Mitsubishi*, 473 U.S. at 627). By ignoring that mandate, Montana has "place[d] arbitration clauses on an unequal 'footing' " with other contract terms, "directly contrary to the Act's language and Congress's intent." *Terminix*, 115 S. Ct. at 843; *see Southland*, 465 U.S. at 15-16. Under the Supremacy Clause, therefore, Montana's statute "must give way." *Perry*, 482 U.S. at 491.

B. *Volt* Does Not Support the Montana Supreme Court's Erroneous Interpretation of the Scope of Section 2.

In its initial opinion, the Montana Supreme Court appeared to concede that the decisions in *Southland* and *Perry*, standing alone, would require enforcement of the arbitration agreement here. App. 21-23. The court found its way around *Southland* and *Perry*, however, by construing this Court's decision in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), as limiting preemption to circumstances where the state law would "undermine the goals and policies of the FAA." App. 26. Applying this approach to Section 2, the court concluded that Montana's law was consistent with the goals and policies of the FAA. App. 27-28. On remand from this Court, the Montana court confirmed that this reading of *Volt* was the sole basis for its decision that Section 2 did not preempt the Montana notice statute. *See* App. 50-53.

The Montana court's reliance on *Volt* is indefensible. To begin with, of course, the court below did just the opposite of what the state court did in *Volt*. Whereas the

state court in *Volt applied* the law chosen by the parties to the contract, the court here *refused* to honor the parties' choice-of-law clause (to the extent that clause can even be said to relate to the issue of enforceability), stating that Connecticut law was contrary to Montana's public policy embodied in the arbitration notice statute. App. 21.[11] While the state court in *Volt enforced* the parties' agreement to arbitrate, the Montana court *voided* their agreement.

As this Court recently explained in *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1216 (1995), *Volt* held that the FAA requires courts "to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms." *Volt*, 489 U.S. at 478. In other words, the "FAA's pro-arbitration policy does not operate without regard to the wishes of the contracting parties," *Mastrobuono*, 115 S. Ct. at 1216, at least when giving effect to those wishes would not do "violence to the policies behind the FAA." *Volt*, 489 U.S. at 479. Nothing in *Volt* even implies that state courts are free, as the Montana Supreme Court considered itself to be, to disregard the parties' agreement to arbitrate on the basis of a state's legislative or judicial hostility toward arbitration.

Having ignored the parties' wishes, the Montana court proceeded to make another mistake by concluding that *Volt* had narrowed the preemptive scope of Section 2. Indeed, this Court had no occasion in *Volt* even to consider the preemptive force of Section 2 with regard to the *enforcement* of arbitration agreements. Rather, *Volt* involved state rules of procedure that this Court observed were "manifestly designed to encourage resort to the

[11] The court also failed to address the parties' agreement (App. 75) to conduct the arbitration proceedings under the American Arbitration Association's Commercial Arbitration Rules, which do not impose any arbitration notice requirement. *See Mastrobuono*, 115 S. Ct. at 1218.

arbitral process." *Volt*, 489 U.S. at 476; *see id.* at 472, 474. The state rules in that case did not render the parties' agreement unenforceable; the rules affected only the timing of the arbitration. *See id.* at 479.

By misusing *Volt*, the Montana Supreme Court sought to grant itself a license to ignore the express requirements of Section 2 and to make its own case-by-case determination whether a particular state law "undermines" the FAA's goals. The court purported to base that authority (App. 27) on the statement by this Court that the FAA does not "occupy the entire field of arbitration." *Volt*, 489 U.S. at 477. But in *Volt*, this Court looked to whether the state procedures in question "would undermine the goals and policies of the FAA" only because the FAA had not "displaced state regulation in [the] area" governed by the state rules. *Id.* at 477-78.[12] While the FAA might be silent about the procedural situation presented in *Volt*, Section 2 speaks in the clearest possible terms to the circumstances under which an agreement to arbitrate must be enforced. *Terminix*, 115 S. Ct. at 843; *Perry*, 482 U.S. at 489-90; *Southland*, 465 U.S. at 10-11, 16. Therefore, state laws that place arbitration agreements "on an unequal 'footing' " by *definition* undermine the goals of the FAA. *Terminix*, 115 S. Ct. at 843; *see also Mastrobuono*, 115 S. Ct. at 1216 (FAA ensures

[12] As described by the Court, the conflict with federal law asserted in *Volt* was not with Section 2 of the FAA, but with Sections 3 and 4, which provide the procedural mechanisms to enforce the substantive rights conferred by Section 2 and which, according to the Court, do not "confer a right to compel arbitration . . . at any time." *Id.* at 474, 476-77; 9 U.S.C. §§ 3, 4. Moreover, unlike the California rules, "the FAA itself contains no provision designed to deal with the special practical problems that arise in multiparty contractual disputes when some or all of the contracts at issue include agreements to arbitrate." *Id.* at 476 n.5. Because the procedural question before the Court in *Volt* was not addressed by the FAA, the California state court's interpretation of the contract as incorporating state rules of arbitration did not impermissibly conflict with the FAA. *Id.* at 477-78.

enforcement of agreement to arbitrate punitive damages claims "even if a rule of state law would otherwise exclude such claims from arbitration").

Nothing in *Volt* itself, therefore, detracts from the holdings in *Southland* and *Perry* that under Section 2 of the FAA, parties may be assured that their agreement to arbitrate will be enforced. *See Terminix*, 115 S. Ct. at 838-39. Indeed, both the Second and First Circuits have found preemption of arbitration notice requirements similar to Montana's *after* the decision in *Volt*. *See David L. Threlkeld & Co. v. Metallgesellschaft Ltd.*, 923 F.2d 245, 249-50 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991); *Securities Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1120 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990). The First Circuit correctly distinguished *Volt* on the ground that, unlike the arbitration notice requirement, the California rules applied in *Volt* "did not impinge on the validity or enforceability of the arbitral contract." *Connolly*, 883 F.2d at 1119 n.3.[13] Even after *Volt*, therefore, Section 2 must still be read to preempt state laws, like the Montana law, that make an arbitration agreement unenforceable even though another type of agreement would be held valid.

[13] In *Saturn Distribution Corp. v. Williams*, 905 F.2d 719, 723-27 (4th Cir.), *cert. denied*, 498 U.S. 983 (1990), the Fourth Circuit considered and rejected the same argument accepted by the Montana Supreme Court: "the notion . . . that the [state] statute may be harmonized with the FAA because it only ensures 'consensual rather than forced arbitration.'" *Id.* at 726 (quoting *Saturn Distribution Corp. v. Williams*, 717 F. Supp. 1147, 1151 (E.D. Va. 1989)). The Fourth Circuit concluded that *Volt* "is not to the contrary." *Id.*; *see also Dowd v. First Omaha Sec. Corp.*, 495 N.W.2d 36, 41 (Neb. 1993).

II. THE MONTANA SUPREME COURT'S DECISION THREATENS TO DISRUPT THE NATIONAL POLICY OF ENFORCING ARBITRATION AGREEMENTS.

The decision below is not only contrary to the express terms of Section 2, the teachings of this Court, and the holdings of every federal court of appeals and state supreme court to have addressed the issue, but also, if affirmed, the decision would seriously disrupt the national uniformity that Congress sought to achieve when it chose to put arbitration agreements on the same footing as other contracts. Arbitration agreements like the one in this case have flourished nationwide as a chosen means of resolving disputes in a wide array of business and consumer contexts. Financial institutions, franchisors, distributors, manufacturers, and a multitude of other companies conducting interstate businesses now regularly include standard arbitration provisions in their contracts. *See generally* Henry C. Strickland, *The Federal Arbitration Act's Interstate Commerce Requirement: What's Left for State Arbitration Law?*, 21 Hofstra L. Rev. 385, 429-54 (1992). The case law on arbitration notice requirements alone illustrates the degree to which national and international economies have come to rely on arbitration in a host of circumstances. *See, e.g., Threlkeld*, 923 F.2d at 246-47 (contract between member of foreign commodities exchange and American trader); *Connolly*, 883 F.2d at 1116 (customer agreement with securities broker); *Webb*, 800 F.2d at 804-05 (same); *Collins*, 467 F.2d at 996 (purchase agreement between manufacturer and its parts supplier); *Bunge*, 685 S.W.2d at 838 (commercial contract for bulk purchase of soybeans); *King v. Postal Annex, Inc.*, No. CV-94-011-GF, slip op. at 2 (D. Mont. Dec. 14, 1995) (franchise agreement); *Snap-On Tools Corp. v. Vetter*, 838 F. Supp. 468, 472 (D. Mont. 1993) (dealership agreement).

Thus, the FAA is, as it was intended, serving to foster a "federal policy favoring arbitration" in a variety of

business and consumer settings. *Moses H. Cone*, 460 U.S. at 24; *see Shearson/American Express*, 482 U.S. at 226; *Perry*, 482 U.S. at 489. The setting of this case is a prime example of the potential benefits of arbitration. A franchise agreement typically involves a continuing business relationship in which disputes can, from time to time, occur. Arbitration is therefore favored by *both* franchisors and franchisees as an effective and efficient means of resolving disputes in that ongoing relationship. *See* Amici Curiae Brief of International Franchise Association and Securities Industry Association at 1-2. Arbitration " 'minimiz[es] hostility and is less disruptive of ongoing and future business dealings among the parties' " than litigation in the courts. *Terminix*, 115 S. Ct. at 843 (quoting H.R. Rep. No. 97-542, at 13 (1982)). Arbitration also "avoid[s] 'the delay and expense of litigation,' " and therefore "appeal[s] 'to big business and little business alike, . . . corporate interests [and] . . . individuals.' " *Id.* at 842 (quoting S. Rep. No. 536, 68th Cong., 1st Sess., 3 (1924)).

It is thus of particular importance that parties to arbitration agreements like the one here be assured that their agreements are enforceable, regardless of whether a particular state is receptive or hostile to arbitration. But the Montana Supreme Court's decision creates new uncertainty in the law that threatens to undermine Congress's support of arbitration as an alternative device for dispute resolution. By formulating a public policy based on the perception that arbitration improperly dispenses with procedural safeguards, see App. 20-21, Montana has sought to resurrect historical misconceptions about arbitration that have long since been rejected by this Court. As this Court has declared, "we are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals [may] inhibit[] the development of arbitration as an alternative means of dispute resolution." *Mitsubishi*, 473 U.S. at 626-27

(1985).[14] More than once, the Court has rebuffed efforts to categorize arbitral tribunals as inadequate alternatives to courts, noting that the FAA and the rules of procedure of major arbitral tribunals similar to the American Arbitration Association adequately protect against biased or incompetent arbitrators and offer parties a fair opportunity to present their claims. *Gilmer*, 500 U.S. at 30-31; *Shearson/American Express*, 482 U.S. at 231-33.[15] The Court has recognized that arbitration does not require a party to "forgo [its] substantive rights"; it only "trades the procedures and opportunity for review of the courtroom for the simplicity, informality and expedition of arbitration." *Mitsubishi*, 473 U.S. at 628.[16]

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[14] The Montana Supreme Court's initial opinion, however, barely disguises its disdain for arbitration, an antipathy that surfaces clearly in the special concurrence penned by the author of the court's opinion. Justice Trieweiler scolded federal courts for their "naive assumption that arbitration provisions are bargained for," App. 30, and appealed to them to understand that arbitration agreements "subvert our system of justice as we have come to know it." App. 32. That concurring opinion is as vivid a reminder as one can imagine of the hostility toward arbitration that Congress addressed in the FAA.

[15] The commercial rules of the American Arbitration Association, which the parties here chose to govern their arbitration, contain ethical provisions applicable to the parties and arbitrators alike and numerous procedural provisions. *See* Martin Domke, 2 *Domke on Commercial Arbitration* App. VII(A) (rev. ed. 1995).

[16] Montana also looks with disfavor on arbitration agreements because they may, as here, require travel to other states. *See* App. 20-21. Yet this Court has dismissed the argument that a policy of focusing the resolution of disputes in one forum is unfair. To the contrary, the Court has underscored the potential benefits of such a policy, even when implemented as part of a nonnegotiable forum selection clause in a standard-form consumer contract. *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 593-94 (1991); *see also Stewart Organization Inc. v. Ricoh Corp.*, 487 U.S. 22, 33 (1988) (Kennedy, J., concurring); *Southland*, 465 U.S. at 7; *Scherk*, 417 U.S. at 518-19; *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 17-18 (1972).

The rule of law announced by the Montana Supreme Court is disruptive and unworkable for anyone transacting business in interstate commerce. The decision below does not take into account the varying, even conflicting, arbitration laws that exist from state to state and their impact on interstate commerce. State arbitration notice provisions are far from uniform. Montana and three other states impose different notice requirements for contracts subject to an agreement to arbitrate.[17] At least six additional states have enacted differing laws regulating the notice, placement or acknowledgment of arbitration agreements within certain kinds of contracts; California added four such statutes in 1994.[18] Furthermore, numerous

[17] Mo. Ann. Stat. § 435.460 (Vernon 1992) (notice that contract contains arbitration agreement must be placed adjacent to signature block in ten-point capital letters); S.C. Code Ann. § 15-48-10(a) (Law. Co-op. Supp. 1995) (notice that contract is subject to arbitration shall be typed in underlined capital letters or rubber-stamped prominently on first page of contract); Vt. Stat. Ann. tit. 12, § 5652(b) (Supp. 1995) (parties must sign written acknowledgment of arbitration that contains language provided in statute and that is prominently displayed in contract).

[18] Cal. Bus. & Prof. Code § 7191 (West 1995) (arbitration provision in contracts for work on residential property is unenforceable unless printed in certain type and unless accompanied by specified notice before signature line); Cal. Health & Safety Code § 1363.1 (West Supp. 1996) (health care service plans requiring binding arbitration must include a disclosure of arbitration in particular terms and in particular location in contract); Cal. Ins. Code § 10123.19 (West Supp. 1996) (similar requirement for disability insurance policies); Cal. Ins. Code § 11512.33 (West Supp. 1996) (similar requirement for nonprofit hospital service plans); Ga. Code Ann. § 9-9-2(c)(8), (9) (Michie Supp. 1995) (arbitration provisions in residential real estate contracts and employment contracts must be separately initialed at the time of contract's execution); Iowa Code Ann. § 679A.1(2)(c) (West 1987) (agreement to arbitrate tort claims must be in separate writing executed by parties); R.I. Gen. Laws § 10-3-2 (Supp. 1995) (arbitration provisions in insurance contracts must be placed immediately above parties' signatures); Tenn. Code Ann. § 29-5-302(a) (Supp. 1995) (arbitration clause in contracts relating to farm or residential

states have placed other conditions on agreements to arbitrate that do not apply to contracts generally. Montana, for example, refuses to enforce arbitration agreements in certain types of contracts where the consideration is $5,000 or less. Mont. Code Ann. § 27-5-114(2)(b) (1995) (reprinted in the Appendix to this brief), *cited in Terminix*, 115 S. Ct. at 843 (O'Connor, J., concurring).[19]

The results of Montana's interpretation of the FAA are evident in this case. The parties legally bound themselves to arbitrate all disputes arising under their franchise agreement. They chose Connecticut law to govern that agreement. Nonetheless, under the decisions of the Montana Supreme Court, the parties have lost the benefit of their agreement to arbitrate because of a state-law principle

property must be separately signed or initialed by parties); Tex. Civ. Prac. & Rem. Code Ann. § 171.001(b) (West Supp. 1996) (excluding from arbitration act any contract by an individual person for acquisition of property or services where consideration is $50,000 or less unless parties agree in writing to submit to arbitration and such agreement is signed by parties *and* their attorneys); Tex. Civ. Prac. & Rem. Code Ann. § 171.001(c) (West Supp. 1996) (personal injury claims excluded from scope of arbitration act except upon advice of counsel to both parties as evidenced by written agreement signed by counsel to both parties). Before September 1, 1995, the Texas provisions were found at Tex. Rev. Civ. Stat. Ann. art. 224(b), (c).

[19] A state-law exclusion from arbitration for small transactions would exclude a significant percentage of disputes that are now subject to arbitration. "[A]ccording to the American Arbitration Association . . ., more than one-third of its claims involve amounts below $10,000 . . . ." *Terminix*, 115 S. Ct. at 843. Georgia similarly excludes from enforcement under its arbitration act any agreement to arbitrate relating to insurance contracts, loan agreements and consumer financing agreements involving $25,000 or less, as well as all contracts involving consumer transactions. Ga. Code Ann. § 9-9-2(c) (Michie Supp. 1995). Similar limitations on the enforceability of arbitration agreements can be found in many states' laws. *See* Strickland, *supra*, at 402 n.98 (citing statutes from 13 different states); *see also Mastrobuono*, 115 S. Ct. at 1215 (New York law barring awards of punitive damages in arbitration).

that no party anticipated would ever be applied to their agreement. A company doing business nationally cannot know in what state it might be sued and—after the decision below—which state's arbitration notice statute it ought to have complied with when entering into an agreement.[20] Although Section 2 of the FAA does subject parties to state laws governing contracts generally, Congress sought by enacting the FAA to remove state-imposed, arbitration-specific impediments to the parties' efforts to arbitrate their disputes because such differential state-law treatment of arbitration would undermine the "declared . . . national policy favoring arbitration." *Southland*, 465 U.S. at 10.[21]

By erecting an additional obstacle to enforcing agreements to arbitrate, Montana has violated the express terms

[20] Missouri requires notice adjacent to the signature block, while Montana requires notice on the first page of the contract. *See* Mo. Ann. Stat. § 435.460 (Vernon 1992); Mont. Code Ann. § 27-5-114(4) (1995). So, for example, if the parties selected Missouri law to govern their contract and they complied with Missouri's notice statute as a protective measure in the event a court construed the choice-of-law clause to incorporate Missouri's arbitration-specific laws, the contract would still not be subject to arbitration if a Montanan brought suit on the contract in Montana state court, as that court would apply Montana's notice statute as a fundamental public policy. *See* App. 21.

[21] Other state courts have applied their state's arbitration notice statute to the case before them, but those decisions made no mention of the FAA or preemption, presumably because no party contended that the arbitration agreement involved interstate commerce. *E.g., Hefele v. Catanzaro*, 727 S.W.2d 475 (Mo. Ct. App. 1987); *A.C. Beals Co. v. Rhode Island Hosp.*, 292 A.2d 865 (R.I. 1972); *Joder Bldg. Corp. v. Lewis*, 569 A.2d 471 (Vt. 1989). At the same time, some state courts have found their own state's notice statutes preempted by the FAA. *E.g., McCarney v. Nearing, Staats, Prelogar & Jones*, 866 S.W.2d 881, 887-88 (Mo. Ct. App. 1993), *transfer denied* (Mo. Jan. 25, 1994); *Woermann Constr. Co. v. Southwestern Bell Tel. Co.*, 846 S.W.2d 790, 792-93 (Mo. Ct. App. 1993); *Godwin v. Stanley Smith & Sons*, 386 S.E.2d 464, 467 (S.C. Ct. App. 1989).

of Section 2 and disrupted the national uniformity that Congress sought to ensure when it made arbitration agreements "valid, irrevocable, and enforceable" as a matter of federal law. 9 U.S.C. § 2. Accordingly, this Court should hold that the Montana notice law is preempted by the FAA. "Having made the bargain to arbitrate, the part[ies] should be held to it . . . ." *Mitsubishi*, 473 U.S. at 628.

CONCLUSION

The judgment of the Supreme Court of Montana should be reversed. The case should be remanded with instructions to reinstate the Montana district court's order staying the plaintiffs' claims "until the arbitration has been had in accordance with the terms of the arbitration agreement." App. 11.

Respectfully submitted,

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APPENDIX

APPENDIX

STATUTE INVOLVED

Section 27-5-114, Montana Code Annotated

27-5-114. Validity of Arbitration agreement—exceptions. (1) A written agreement to submit an existing controversy to arbitration is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract.

(2) A written agreement to submit to arbitration any controversy arising between the parties after the agreement is made is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract. Except as permitted under subsection (3), this subsection does not apply to:

(a) claims arising out of personal injury, whether based on contract or tort;

(b) any contract by an individual for the acquisition of real or personal property, services, or money or credit where the total consideration to be paid or furnished by the individual is $5,000 or less;

(c) any agreement concerning or relating to insurance policies or annuity contracts except for those contracts between insurance companies; or

(d) claims for workers' compensation.

(3) A written agreement between members of a trade or professional organization to submit to arbitration any controversies arising between members of the trade or professional organization after the agreement is made is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract.

(4) Notice that a contract is subject to arbitration pursuant to this chapter shall be typed in underlined capital letters on the first page of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration.

No. 95-559

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

DOCTOR'S ASSOCIATES, INC. AND NICK LOMBARDI,
Petitioners,

v.

PAUL CASAROTTO AND PAMELA CASAROTTO,
Respondents.

On Writ of Certiorari to the
Supreme Court of Montana

BRIEF FOR RESPONDENTS

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March 15, 1996

QUESTION PRESENTED

Does Section 2 of the Federal Arbitration Act — which provides for the enforcement of voluntary arbitration agreements — preempt a state law aimed at assuring that such agreements are, in fact, knowingly entered?

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Montana Legislative History

MISCELLANEOUS

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

No. 95-559

DOCTOR'S ASSOCIATES, INC. AND NICK LOMBARDI,
Petitioners,

v.

PAUL CASAROTTO AND PAMELA CASAROTTO,
Respondents.

On Writ of Certiorari to the
Supreme Court of Montana

BRIEF FOR RESPONDENTS

STATEMENT OF THE CASE

In April 1988, respondent Paul Casarotto signed an 11-page standard form franchise agreement with petitioner Doctor's Associates, Inc. (DAI) to open a Subway sandwich shop in Great Falls, Montana. J.A. 86-87. Unbeknownst to Mr. Casarotto, on page nine of the agreement was a provision mandating arbitration of all disputes between the parties in Bridgeport, Connecticut. J.A. 86-87. The franchise agreement did not provide notice on the front page in underlined capital letters that the contract was subject to arbitration, as required by Montana statute. Mont. Code Ann. § 27-5-114(4) (1995). The question presented is whether the Montana statute, which is aimed at assuring that parties *know* that they are signing an agreement containing an arbitration clause, is preempted by the Federal Arbitration

Act, 9 U.S.C. § 2 ("FAA"). To answer that question, we begin with the history of the Montana arbitration statute and then turn to the facts of this case and the rulings below.

A. The Montana Arbitration Statute.

In 1985, the Montana legislature adopted the Uniform Arbitration Act. Mont. Code Ann. tit. 27, ch. 5. Prior to the adoption of the Act, the Montana courts refused to enforce arbitration agreements based upon an 1895 statute that voided contractual provisions in which a party "is restricted from enforcing his rights under the contract by the usual proceedings in the ordinary tribunals or which limits the time within which he may thus enforce his rights." Mont. Code Ann. § 28-2-708 (1984). *See, e.g., Palmer Steel Structures v. Westech, Inc.*, 584 P.2d 152 (Mont. 1978) (contract provisions which require parties to submit future disputes to arbitration are void as applied to questions of law). This provision codified a common law prohibition on contractual restraints upon legal proceedings that existed in Montana prior to the adoption of the Montana Code in 1895. *Wortman v. Montana Cent. Ry. Co.*, 56 P. 316, 321 (Mont. 1899).

In 1984, this Court announced its decision in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), regarding the preemptive scope of section 2 of the FAA, 9 U.S.C. § 2. That provision makes an arbitration agreement "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." *Id.* In *Southland*, this Court concluded that section 2 "appl[ies] in state as well as federal courts," 465 U.S. at 12, and "withdr[aws] the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Id.* at 10. In the

wake of this Court's *Southland* decision, the Montana legislature adopted the Uniform Arbitration Act to validate arbitration agreements and to amend section 28-2-708 to exclude arbitration agreements. *See* Mont. Code Ann. tit. 27, ch. 5; Mont. Code Ann. § 28-2-708 (1995).

The principal purpose of the legislation was to allow parties to enforce pre-dispute arbitration agreements. As the bill's sponsor, State Senator Joe Mazurek, explained:

> Even though Montana has arbitration statutes on the books, there is existing case law and statutes in Montana which prohibit parties from agreeing in advance of a dispute to submitting it to arbitration. What this bill would do is allow parties in advance of any dispute arising [to] agree[] to submit a dispute to arbitration and adopts the Uniform Arbitration Act which establishes the procedures under which an arbitration would occur and provides the means for enforcement of awards. . . . [The] principal concern is making the commercial setting where the parties are already arbitrating enforceable.

Hearings on Adopting the Uniform Arbitration Act, S.B. 110, before the Senate Judiciary Committee, 49th Leg. (January 21, 1985) (minutes of the Senate Judiciary Committee, at 6); *see also Hearings on Adopting the Uniform Arbitration Act, S.B. 110, before the House Judiciary Committee*, 49th Leg. (March 13, 1985) (minutes of the House Judiciary Committee, at 2) ("[T]he bill makes a very significant change in Montana law. It allows parties to enter into an

agreement today to arbitrate a dispute which arises in the future. That is currently prohibited by Montana law.").[1]

During the consideration of Montana's Uniform Arbitration Act, the testimony and legislative statements focused on the positive aspects of arbitration. *See, e.g., Hearings on Adopting the Uniform Arbitration Act, S.B. 110, before the Senate Judiciary Committee*, 49th Leg. (January 21, 1985) (minutes of the Senate Judiciary Committee, at 6) (arbitration is less expensive, less cumbersome means of settling disputes; bill will alleviate current clogging of the courts). Concerns were raised, however, about adhesion contracts. *Id.* at 7 (testimony of Montana Trial Lawyers Association). For example, Senator Tom Towe told the Committee about Nannabelle Nickleberry, an elderly woman who signed a home improvement contract which required that disputes be arbitrated in New York. *Id.* at 8. In response to such concerns, the legislation was amended to include the provision at issue in this case:

> Notice that a contract is subject to arbitration pursuant to this chapter shall be typed in underlined capital letters on the first page of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration.

Mont. Code Ann. § 27-5-114(4); *see also Hearings on Adopting the Uniform Arbitration Act, S.B. 110, before the Senate Judiciary Committee*, 49th Leg. (February 6, 1985) (minutes of the Senate Judiciary Committee, at 8). This is not the only provision that the Montana legislature has

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[1]A copy of the state legislative history is being lodged with the Clerk and served on counsel for petitioners.

enacted to require conspicuous notice of particular terms in standardized form contracts. For example, the Montana Code requires that retail installment contracts provide notice of particular rights in large bold type and that installment contracts for motor vehicles include a specific statement that liability insurance coverage is not included if that is the case. Mont. Code Ann. §§ 31-1-231(2) & (3).

Following the adoption of the Uniform Arbitration Act in 1985, the Montana Supreme Court has repeatedly enforced arbitration agreements. *See Chor v. Piper, Jaffray & Hopwood, Inc.*, 862 P.2d 26 (Mont. 1993); *Downey v. Christensen*, 825 P.2d 557 (Mont. 1992); *Vukasin v. D.A. Davidson & Co.*, 785 P.2d 713 (Mont. 1990); *William Gibson, Jr., Inc. v. James Graff Communications, Inc.*, 780 P.2d 1131 (Mont. 1989); *Larsen v. Opie*, 771 P.2d 977 (Mont. 1989); *Passage v. Prudential-Bache Secs., Inc.*, 727 P.2d 1298 (Mont. 1986). Thus, as long as parties comply with Mont. Code Ann. § 27-5-114, they can rely on the Montana courts to enforce their agreements to arbitrate.

B. The Casarottos' Dispute with DAI.

In April 1988, Paul Casarotto signed a franchise agreement with DAI to open a Subway sandwich shop in Great Falls, Montana. J.A. 86-87. It was the first and only franchise agreement that Mr. Casarotto had ever signed. J.A. 87. He was told during his phone conversations with DAI representatives that it was a standard agreement and that he could make no changes or modifications to it. J.A. 86-87. There was no indication on the first page of the contract that it was subject to arbitration. J.A. 65. However, on page 9, at paragraph 10(c), the contract included a provision that would require Mr. Casarotto to travel more than two

thousand miles to Bridgeport, Connecticut, to arbitrate any disputes arising out of the contract:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost of such a proceeding will be borne equally by the parties.

J.A. 75. The contract also included a provision stating that Connecticut law would govern the contract. J.A. 77. Although Mr. Casarotto admits that he read the agreement before signing it, no one ever told or explained to him that the agreement contained an arbitration clause nor did he understand that he was surrendering his right to sue DAI in Montana. J.A. 87.

The franchise agreement provided that the location of the Subway shop had to be approved by DAI. J.A. 68. After the franchise agreement was signed, DAI assigned Nick Lombardi, an independent contractor, to serve as its Montana Development Agent.[2] Amended Complaint, ¶ 9,

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[2]Mr. Lombardi did not sign the franchise agreement, but appears to claim that he is also entitled to arbitration of the (continued...)

R. 6. Lombardi informed Mr. Casarotto that the location he preferred in Great Falls was not yet available. J.A. 14. Based on Lombardi's promise reserving for him the exclusive right to open a Subway shop in the preferred location when it became available, Mr. Casarotto agreed to open a shop at a less desirable location. J.A. 14. Contrary to their promise, however, Lombardi and DAI subsequently awarded the preferred location to another franchisee. J.A. 14. As a result, the Casarottos lost their business and the collateral securing their loan. J.A. 14.

C. Proceedings Below.

In 1992, respondents Paul and Pamela Casarotto filed suit against petitioners DAI and Lombardi alleging that they breached their agreement with the Casarottos, defrauded them, breached the covenant of good faith and fair dealing, and engaged in other tortious conduct, all of which directly

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[2](...continued)
Casarottos' claims against him, based on a franchise agreement to which he is not a party. Although DAI refers to Lombardi as its development agent, DAI has been equivocal regarding Lombardi's agency status in the proceedings below. Pet. Brief at 3; Appellees' Response Brief in *Casarotto v. Lombardi*, 886 P.2d 931 (Mont. 1994) at 7-8, 21-22, 26. Without conceding the point, even if one were inclined toward the view that the FAA preempts the Montana notice statute, the question remains whether Nick Lombardi can benefit from the arbitration clause since he was not a signatory to the franchise agreement, was not an employee of the signatory (DAI), and was not clearly acting in the capacity as an agent of the signatory. At a minimum, the record has not been sufficiently developed to encompass Lombardi within this arbitration agreement. Because the Montana Supreme Court did not reach the issue of whether the arbitration clause in DAI's franchise agreement would extend to the Casarottos' claims against Lombardi, that issue is not presented here.

caused the Casarottos' loss of business and the resulting damage.[3] J.A. 14.

Petitioners moved in the state district court to dismiss or stay the judicial proceedings pending arbitration, citing the arbitration provisions in the franchise agreement. The district court stayed the lawsuit against DAI and Lombardi pending arbitration pursuant to section 3 of the Federal Arbitration Act. J.A. 10-11. The Casarottos appealed to the Montana Supreme Court.

The Montana Supreme Court reversed, holding that the Casarottos' claims could be litigated. The court reached that result in two steps. First, applying conflict of law principles established in Montana case law, the court held that Montana law governed the franchise agreement between Casarotto and DAI. J.A. 16-21. The Montana court determined that Montana had a materially greater interest than Connecticut in a contract negotiated in Montana, to be performed in Montana, regarding a sandwich shop in Montana, and entered between a Montana resident and a Connecticut corporation. J.A. 19. The Montana court then found that the contractual provision selecting Connecticut law was ineffective because it sought to override the Montana notice of arbitration provision. It found that to apply Connecticut law would violate Montana's fundamental public policy that citizens of Montana are entitled to notice before entering an

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[3]The Casarottos also asserted claims against other Subway franchisees who managed the Casarottos' store. No one has asserted that DAI's arbitration clause is so far reaching as to encompass those claims, which are still pending in the Montana district court.

agreement to waive their right of access under the Montana constitution to Montana's courts. J.A. 20-21.

Second, having determined that the franchise agreement is governed by Montana law, the Montana court then considered whether the notice requirement in Mont. Code Ann. § 27-5-114(4) is preempted by the Federal Arbitration Act. Relying on this Court's analysis in *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468 (1989), the Montana court found that Montana's notice statute is consistent with the goals and policies of the FAA:

> Our conclusion that Montana's notice requirement does not undermine the policies of the FAA is based on the Supreme Court's conclusion that it was never Congress's intent when it enacted the FAA to preempt the entire field of arbitration, and its further conclusion that the FAA does not require parties to arbitrate when they have not agreed to do so. That Court held that the purpose of the FAA is simply to enforce arbitration agreements into which parties had entered, and acknowledged that the interpretation of contracts is ordinarily a question of state law. *Volt*, 489 U.S. at 474.
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> Presumably, therefore, the Supreme Court would not find it a threat to the policies of the Federal Arbitration Act for a state to require that before arbitration agreements are enforceable, they be entered knowingly.

J.A. 27. As the Montana court further noted, "Montana's notice requirement does not preclude parties from knowingly entering into arbitration agreements, nor do our courts

decline to enforce arbitration agreements which are entered into knowingly." J.A. 28. Therefore, the court found that Montana's notice statute is not preempted, and reversed the district court's order staying the litigation. J.A. 28.

Petitioners sought review in this Court, which summarily vacated the Montana court's decision and remanded for further consideration in light of an intervening decision, *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 115 S. Ct. 834 (1995). 115 S. Ct. 2552 (1995). In *Terminix*, this Court held that section 2 of the Federal Arbitration Act, which makes enforceable a written arbitration provision in "a contract evidencing a transaction involving commerce," reaches broadly to the limits of Congress' Commerce Clause power. 115 S. Ct. at 839-40. Accordingly, this Court reversed an Alabama Supreme Court decision applying a state law making pre-dispute arbitration agreements unenforceable based on the Alabama court's finding that the FAA did not apply to the termite contract at issue there. *Id.* at 837.

On remand, the Montana Supreme Court concluded that its prior decision was consistent with *Terminix*. J.A. 54. The central issue in *Terminix* was whether the contract at issue evidenced "a transaction involving commerce." J.A. 53. The Montana court presumed that the Casarottos' case involved interstate commerce and that any state law which frustrated the purposes of the FAA would be preempted. J.A. 53. The court noted that the challenged Montana statute does not make arbitration agreements invalid and unenforceable; it simply requires notice of an arbitration clause in a contract. J.A. 53. *See also* J.A. 55 (Leaphart, concurring) (the notice statute "furthers the policy of meaningful and consensual arbitration by helping ensure that

the consumer who signs what is most often a nonnegotiated, form contract, knowingly agrees to arbitration in the event of a dispute."). Finally, the Montana court noted that *Terminix* in no way modified the principles from *Volt* on which the Montana court had relied. J.A. 54. Accordingly, the Montana Supreme Court reaffirmed and reinstated its prior decision. J.A. 54. This Court granted certiorari on January 5, 1996.[4]

SUMMARY OF ARGUMENT

Unlike the state requirements that this Court has heretofore found preempted by the Federal Arbitration Act, the Montana notice provision does not reflect any hostility toward the enforcement of arbitration agreements that are knowingly entered. To the contrary, this statutory provision was enacted in the course of modernizing Montana law to bring it into compliance with the FAA by requiring that arbitration agreements are enforceable. Its function is not to prevent arbitration but to help ensure that arbitration is indeed consensual.

Under the Federal Arbitration Act, arbitration is a matter of consent. *Volt*, 489 U.S. at 479. This Court in

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[4]The propriety of the Montana Supreme Court's choice-of-law determination is not before this Court despite petitioners' reference to it. Pet. Brief at 17 n. 10. The only basis on which that ruling could be overturned by this Court is that Montana's choice of law decision violates due process. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985). Because petitioners did not seek review of this conclusion, but only of the meaning of section 2 of the FAA, the Court should not consider it. *See Bray v. Alexandria Women's Health Clinic*, 113 S. Ct. 753, 764-65 (1993); *Berkemer v. McCarty*, 468 U.S. 420, 443 n.38 (1984).

Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213 (1985), explained that the Act arose not from a desire to force disputes to arbitration, but from the need to overcome an anachronistic judicial hostility to arbitration agreements carried over from English common law. *Id.* at 219-20. "The Act, after all, does not mandate the arbitration of all claims, but merely the enforcement — upon the motion of one of the parties — of privately negotiated arbitration agreements." *Id.* at 219.

Recognizing that, in many instances, arbitration agreements are not "negotiated," but are instead contained in standardized form contracts that are offered on a take-it-or-leave-it basis, like the franchise agreement at issue here, the Montana legislature included a provision in the Uniform Arbitration Act to ensure that parties have actual notice that a contract contains an arbitration clause. Mont. Code Ann. § 27-5-114(4). This notice requirement is not preempted by the Federal Arbitration Act for two reasons.

First, the statute simply codifies general common law contract principles that require unexpected provisions in standardized contracts to be conspicuous. *See* Restatement (Second) of Contracts § 211 (Standardized Agreements) (c), cmt. f. An arbitration provision like the one in the franchise agreement between Mr. Casarotto and DAI is surely vulnerable under a common law contract theory because the standardized form provision for mandatory arbitration two thousand miles away was not within the reasonable expectations of the agreeing party. *See Broemmer v. Abortion Servs. of Phoenix Ltd.*, 840 P.2d 1013 (Ariz. 1992) (standardized form contract which required patient to arbitrate medical malpractice disputes was unenforceable as falling outside patient's reasonable expectations where there

was no conspicuous waiver); *Wheeler v. St. Joseph Hosp.*, 63 Cal.App.3d 345, 361 (1976) (applying adhesion contract principles to an arbitration clause, court found no agreement to arbitrate where clause not specifically called to the patient's attention).

The FAA only requires the enforcement of arbitration agreements to which the parties have consented. The issue of whether a party has knowingly consented to arbitration is a matter of state law, and the FAA expressly provides that states may invalidate arbitration clauses that fail under general principles of contract law. 9 U.S.C. § 2; *see also Terminix*, 115 S. Ct. at 843 ("States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause 'upon such grounds as exist at law or in equity for the revocation of *any* contract.'") (emphasis added). Thus, a state court decision declining to enforce an arbitration clause in a form contract, on the ground that it is not conspicuous, is not preempted by the FAA because section 2 allows states to invalidate arbitration clauses on generally applicable principles of law and equity.

For the same reason, Montana's notice statute is not preempted because the statute simply codifies the common law by requiring arbitration agreements — which are certainly "unexpected" since they had been barred in Montana for over a century — to be conspicuously displayed in order for the court to conclude that the party who did not draft the agreement knowingly agreed to arbitration. Because invalidation of arbitration clauses under the general principle that unexpected terms be conspicuous is permitted by the FAA, the FAA does not preempt a state statute that, as here, codifies the requirement that arbitration clauses be

conspicuous. Indeed, the codification of the conspicuousness requirement benefits those drafting arbitration agreements by relieving them of the uncertainties of case-by-case adjudication of whether a clause is sufficiently conspicuous.

Second, the Montana notice statute is not preempted by the FAA because it does not prevent parties from entering enforceable arbitration agreements, nor does it allow courts to refuse to enforce agreements that are knowingly entered. Thus, the statute does not conflict with the FAA's basic purpose, "to overcome courts' refusals to enforce agreements to arbitrate." *Terminix*, 115 S. Ct. at 838. Indeed, by ensuring that arbitration agreements are entered knowingly, and by establishing a bright-line rule for when appropriate notice and consent have been given, the Montana statute furthers the pro-arbitration policy of the FAA. If notice of the arbitration clause is provided as required by the Montana statute, a party to the contract will be unable to claim that an arbitration agreement was not within her reasonable expectations.

Finally, petitioners' claim that the Montana notice statute is "disruptive and unworkable for anyone transacting business in interstate commerce" is vastly overblown. Pet. Brief at 26. Sophisticated market participants transacting business in multiple states already are obliged to adapt their form contracts, franchise agreements, leases, insurance policies, or securities registrations to the specific requirements of diverse jurisdictions. Companies that are already highly regulated by the states will have no significant difficulty complying with a simple state arbitration notice requirement, and will surely not suffer enough of a burden to frustrate the purposes of the FAA. Indeed, by codifying this common law requirement of conspicuous notice,

Montana has made it easier for foreign corporations to ascertain and comply with Montana law.

ARGUMENT

I. THE MONTANA NOTICE REQUIREMENT IS NOT PREEMPTED BECAUSE THE STATE STATUTE REPRESENTS A CODIFICATION OF GENERAL CONTRACT LAW PRINCIPLES.

The Federal Arbitration Act was enacted in 1925 to ensure that courts enforced agreements to arbitrate. *Terminix*, 115 S. Ct. at 838; *see also* 66 Cong. Rec. 984 (1924) (statement of Senator Walsh) ("[T]he bill provides for the abolition of the rule that agreements for arbitration will not be specifically enforced."). The "FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration." *Volt*, 489 U.S. at 477. Indeed, Congress expressly limited the preemptive reach of the FAA by allowing states to invalidate arbitration provisions "on such grounds as exist at law or equity for the revocation of any contract." 9 U.S.C. § 2.

"Congress' principal purpose" in enacting the FAA was to ensure that "private arbitration agreements are enforced according to their terms." *Volt*, 489 U.S. at 478. Thus, this Court has held that state laws which "require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration" are preempted. *Southland*, 465 U.S. at 10 (state law that made agreements to arbitrate certain franchise claims unenforceable held preempted because it "directly conflicts" with section 2 of the Act); *Perry v. Thomas*, 482 U.S. 483, 491 (1987)

(similar state law barring enforcement of agreement to arbitrate wage-collection claims held preempted because it was in "unmistakable conflict" with federal policy).

However, this Court has "recognized that the FAA does not require parties to arbitrate when they have not agreed to do so." *Volt*, 498 U.S. at 478. The federal policy favoring arbitration is not designed to promote the broader use of arbitration, but rather to "give effect to the contractual rights and expectations of the parties. . . ." *Id.* at 479; *see also* H.R. Rep. 96, 68th Cong., 1st Sess. 1 (1924) ("[E]ffect of the bill is simply to make the contracting party live up to his agreement."). Thus, the Act only requires arbitration where the parties have contractually bound themselves to arbitrate their disputes. *See Volt*, 489 U.S. at 479 ("Arbitration under the Act is a matter of consent, not coercion."); S. Rep. No. 536, 68th Cong., 1st Sess. 1, 3 (1924) ("The record . . . shows not only the great value of *voluntary* arbitrations but the practical justice in the enforced arbitration of disputes where written agreements for that purpose have been *voluntarily* and *solemnly* entered into.") (emphasis added); *see also Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 414 (1967) (legislative history demonstrates that Act was not intended to cover arbitration clauses offered to captive customers or employees on a take-it-or-leave-it basis) (Black, J. dissenting), (citing *Hearing on S. 4213 and S. 4214 before the Subcommittee of the Senate Committee on the Judiciary*, 67th Cong., 4th Sess. 9-11 (1923)).

This Court has held repeatedly that "the arbitrability of the merits of a dispute depends upon whether the parties agreed to arbitrate that dispute." *First Options of Chicago, Inc. v. Kaplan*, 115 S. Ct. 1920, 1923 (1995), (citing *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1216 (1995); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*, 473 U.S. 614, 626 (1985)). As this Court noted in its most recent decision on arbitration:

> [T]he basic objective in this area is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes, but to ensure that commercial arbitration agreements, like other contracts, 'are enforced according to their terms,' and according to the intentions of the parties.

First Options, 115 S. Ct. at 1925 (citations omitted).

The threshold issue, then, is whether an agreement to arbitrate exists. To decide whether the parties actually agreed to arbitrate, courts generally "should apply ordinary state-law principles that govern the formation of contracts." *Id.* at 1924, (citing *Mastrobuono*, 115 S. Ct. at 1219 & n.9; *Volt*, 489 U.S. at 475-76; *Perry*, 482 U.S. at 492-93 n.9). In this case, the Montana court looked to compliance with the Montana notice statute and invalidated the arbitration provision on that ground. J.A. 28. However, as demonstrated below, this statute is little more than a particular application and codification of general state law contract principles that govern standardized form contracts and that could also have been applied to invalidate the arbitration clause at issue here.

A. General Contract Principles Invalidate Terms in Standardized Contracts That Are Beyond The Reasonable Expectations of a Party.

The law treats contracts of adhesion or standard form contracts, such as the franchise agreement signed by Mr. Casarotto, differently from "ordinary" contracts. *See*

generally Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 Harv. L. Rev. 1174 (1983). While standardized agreements serve a useful purpose, courts recognize that the adhering party is unlikely to have read, let alone understood, many of the standard terms before signing the document. Restatement (Second) Contracts § 211, cmts. a & b; *see also* Rakoff, *supra*, at 1179 and citations in nn. 21 & 22. Thus, parties "are not bound to unknown terms which are beyond the range of reasonable expectation." Restatement (Second) Contracts § 211, cmt. f; *see, e.g., C & J Fertilizer, Inc. v. Allied Mut. Ins. Co.*, 227 N.W.2d 169, 176-77 (Iowa 1975) (doctrine of reasonable expectations invalidates insurance policy provision); *Mills v. Agrichemical Aviation, Inc.*, 250 N.W.2d 663, 671-73 (N.D. 1977) (same).

To determine whether an unexpected term in a standard form contract should be rendered unenforceable, courts look, in part, to the conspicuousness of the term. Restatement (Second) Contracts § 211, cmt. f. For example, in *Sierra Diesel Injection Serv., Inc. v. Burroughs Corp.*, 890 F.2d 108 (9th Cir. 1989), the court excluded warranty disclaimer clauses from a standard form contract because they were not within the reasonable expectations of the signing party and were not conspicuous. *Id.* at 113-14. Similarly, in *Cate v. Dover Corp.*, 790 S.W.2d 559 (Tex. 1990), the court held that "to be enforceable, a written disclaimer of the implied warranty of merchantability : . . must be conspicuous to a reasonable person." *Id.* at 562. According to the *Cate* court, the purpose of the conspicuousness requirement is "to protect the buyer from surprise and an unknowing waiver of his or her rights." *Id.* at 561. Echoing the holding of the *Cate* court, the court in *Burgess Constr. Co. v. State*, 614

P.2d 1380 (Alaska 1980) explained a common judicial response to contracts of adhesion: "An unusual or unexpected term in an adhesion contract which falls outside the weaker party's 'reasonable expectations' will be denied effect against him, unless it has been brought to his attention by express notice, as by clear, plain and conspicuous language on the face of the contract." *Id.* at 1384. The conspicuousness of the term is a significant factor in determining whether provisions contrary to the reasonable expectations of the adhering party will be denied enforcement because the "effect of an adequate notice, of course, is simply to alter preexisting expectations." *Graham v. Scissor-Tail, Inc.*, 623 P.2d 165, 173 n.18 (Cal. 1981).

Thus, courts have repeatedly refused to enforce limitations on liability in standardized form contracts in the absence of plain, clear, and explicit notice. *See, e.g., Steven v. Fidelity and Casualty Co. of New York*, 377 P.2d 284, 288-94 (Cal. 1963) (insurance policy provisions contrary to the reasonable expectations of the adhering party denied enforcement in the absence of "plain and clear notification" and "an understanding consent"); *Transamerica Ins. Co. v. Royle*, 656 P.2d 820, 824 (Mont. 1983) ("[H]ousehold exclusion clause [in insurance policy] is invalid due to its failure to 'honor the reasonable expectations' of the purchaser of the policy.").

B. Inconspicuous Arbitration Provisions in Standardized Agreements May Be Invalidated Under General Contract Principles.

The general principle of "reasonable expectations" governing all standardized form contracts has also been applied to invalidate arbitration clauses. *See Broemmer v.*

Abortion Servs. of Phoenix, Ltd., 840 P.2d 1013 (Ariz. 1992) (adhesion contract which required patient to arbitrate medical malpractice disputes was unenforceable as falling outside patient's reasonable expectations where there was no conspicuous waiver); *Wheeler v. St. Joseph Hosp.*, 63 Cal.App.3d 345, 361 (1976) (applying adhesion contract principles to an arbitration clause, court found no agreement to arbitrate where clause not called to the patient's attention). The reasonable expectations doctrine is not, of course, applied indiscriminately to invalidate all arbitration clauses in standardized form contracts. Instead, the ultimate question is whether the clause was outside the reasonable expectations of the party signing the contract. *See* John L. Di Fiore, *Problems in Alternative Dispute Resolution: Arbitration Agreements as Contracts of Adhesion in Consumer Securities Disputes*, 93 Com. L.J. 259, 276-77 (1988) (arbitration not reasonably anticipated by the ordinary individual in certain factual circumstances).

Thus, while Montana law recognizes the general principle that unexpected provisions in standardized contracts are invalid if not conspicuous, in two cases where the claim was raised, the Montana Supreme Court has rejected the argument that arbitration clauses in adhesion contracts are void when the record does not support the claim that the clause was outside the reasonable expectations of the adhering party. *See Chor v. Piper, Jaffray & Hopwood, Inc.*, 862 P.2d 26, 30 (Mont. 1993); *Passage v. Prudential-Bache Securities, Inc.*, 727 P.2d 1298, 1301-02 (Mont. 1986). Both cases involved brokerage agreements. In *Passage*, the Montana court found that "[t]here is nothing in the record to indicate that the arbitration clause in the [one-page] client agreement form was not within the parties'

reasonable expectations." 727 P.2d at 1302. In *Chor*, the court relied on the plaintiff's own testimony that she read the arbitration agreements before signing them and understood that "'if I were to have any problems, that we would agree to arbitrate the problem.'" 862 P.2d at 30. Based on the plaintiff's actual knowledge of the arbitration clause, the court refused to invalidate the arbitration provision even though the court was well aware that the statutory notice requirement had not been met. *Id.* at 34.

Thus, any argument that the Montana notice statute is overbroad because it applies to situations beyond what the common law would allow must be rejected. The Montana Supreme Court will not invalidate an arbitration provision based solely on noncompliance with the statutory notice requirement, if the signing party knew and understood that he or she was signing a contract that included an arbitration provision. *Id.*; *see also Cate*, 790 S.W.2d at 562 (inconspicuous disclaimer of implied warranty of merchantability is unenforceable "unless the buyer has actual knowledge of the disclaimer"). On the other hand, while the Montana court rejected arguments based on adhesion contract principles in *Passage* and *Chor*, the Court affirmed the vitality of the doctrine and plainly left the door open to the possibility that, in a more compelling case, it would void the arbitration provision.

The facts of the instant case clearly fall within the general principle that inconspicuous, unexpected clauses are not enforceable. Here, the contract at issue was the first and only franchise agreement that Mr. Casarotto had ever signed. J.A. 87. Mr. Casarotto was told that it was a standard agreement and that he could make no changes or modifications to it. J.A. 87. There were no negotiations

over the terms of the agreement; Mr. Casarotto could only take it or leave it.[5] And, although Mr. Casarotto read the agreement before signing it, he did not realize that he was giving up his right to sue DAI in Montana. J.A. 87. Based on these facts, even absent the Montana notice statute, the Montana court could well have found that the franchise agreement was a standardized form contract and that, because the arbitration provision was not conspicuous and was not within the reasonable expectations of Mr. Casarotto, it was invalid.[6]

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[5]Mr. Casarotto's experience in this regard is not uncommon. According to a 1990 report by the House of Representatives Committee on Small Business, a "serious imbalance of power exists" between franchisors and franchisees: "Advantages of financial strength, access to information and to legal advice create a gross disparity of bargaining power in favor of the franchisor that results in one-sided franchise agreements that are offered, and generally accepted, on a take-it-or-leave-it basis." *Staff of House Comm. on Small Business, 101st Cong., 2d Sess., Franchising in the U.S. Economy: Prospects and Problems* 49 (Comm. Print 101-4, 1990).

[6]Indeed, the Montana court has recognized that, in franchise agreements, the franchisor often has a superior bargaining position. *See Dunfee v. Baskin Robbins, Inc.*, 720 P.2d 1148, 1150 (Mont. 1986). In a case involving a remarkably similar dispute to the merits of this case, the Montana court upheld a jury's verdict that a franchisor had breached the duty of good faith by refusing the franchisee's request to relocate and by misrepresenting the lease arrangement during the discussions. *Id.* at 1154. In so holding, the Montana court recognized that the dispute did not arise from a negotiated contract but from a form contract and looked to the "reasonable expectations" of the weaker party, the franchisee. *Id.* at 1153; *see also* Scott Burnham, *Bad Faith: Courts Find Breaches of Fair Dealing Applicable to Commercial Contracts Too*, Mont.

(continued...)

The fact that a state court might invalidate an arbitration agreement under adhesion contract principles does not reflect any hostility towards arbitration agreements. For example, in finding an arbitration clause invalid, a California appellate court emphasized that "there is no rule or public policy against an agreement between a patient and a hospital to arbitrate any medical malpractice claim arising out of the hospitalization." *Wheeler v. St. Joseph Hosp.*, 63 Cal.App.3d at 354. Rather, the issue before the court was whether the plaintiffs had indeed agreed to arbitrate the controversy. *Id.* Recognizing that "[i]t has long been the public policy of this state to favor arbitration over litigation as a means of settling disputes because it is expeditious, avoids the delays of litigation, and relieves court congestion," *id.* at 355, the court nonetheless held that the policy favoring arbitration "cannot displace the necessity for a voluntary agreement to arbitrate." *Id.* at 356. The *Wheeler* court then applied adhesion contract principles to invalidate the arbitration provision.[7] *Id.* at 369.

A court decision invalidating a particular arbitration clause based on generally applicable standardized contract principles is not preempted by the FAA. As this Court stated last term, "States may regulate contracts, including

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[6](...continued)
Law. 6, 9 (Nov. 1986) (*Dunfee* court recognized one-sided nature of franchise agreement).

[7]The legal analysis of the California courts concerning adhesion contract principles is particularly relevant here because the Montana courts often look to California case law for contract interpretation because Montana adopted the California Code as it applied to contracts in 1895. *See Miller v. Fallon County*, 721 P.2d 342, 346 (Mont. 1986).

arbitration clauses, under general contract law principles and they may invalidate an arbitration clause 'upon such grounds as exist at law or in equity for the revocation of *any* contract.'" *Terminix*, 115 S. Ct. at 843 (citing 9 U.S.C. § 2); *see also Rodriguez De Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 483-84 (1989) (relief "upon grounds 'for the revocation of any contract'" protects "buyers of securities by removing 'the disadvantages under which buyers labor' in their dealings with sellers").

The Montana notice statute is a codification of and particularized application of general common law contract principles that would have allowed the Montana court to invalidate the arbitration provision in this case and in others as well. Indeed, when the statute was enacted, Montana was overruling a century-old law that arbitration agreements were not enforceable, and therefore, it was surely reasonable for the Montana legislature to consider an arbitration clause to be an unexpected term that requires conspicuous notice.

Rather than require the courts to litigate claims that an inconspicuous arbitration provision was beyond a party's reasonable expectations on a case-by-case basis, the Montana legislature has established a bright-line rule that is easily followed by contracting parties. Since the FAA allows states to protect parties from being bound by unknown contract terms under traditional contract law doctrines enforced by the courts, the state legislatures and governors must also have authority to ensure that arbitration agreements are entered into knowingly and voluntarily through statutory enactments based on those same contract doctrines. After all, by serving as a prophylactic against "claims that the agreement to arbitrate resulted from . . . fraud or overwhelming economic power," *Mitsubishi Motors*, 473 U.S. at 627, state laws like

Montana's advance the primary purpose of the Act by making it more likely that arbitration agreements will be enforced.

II. MONTANA'S EFFORT TO ENSURE THAT ARBITRATION AGREEMENTS ARE ENTERED VOLUNTARILY IS NOT PREEMPTED BECAUSE ITS NOTICE REQUIREMENT DOES NOT CONFLICT WITH THE OPERATION OF THE FEDERAL ARBITRATION ACT.

The "basic purpose of the Federal Arbitration Act is to overcome courts' refusals to enforce agreements to arbitrate." *Terminix*, 115 S. Ct. at 838; *see also Shearson/American Express Inc. v. McMahon*, 482 U.S. 220, 225 (1987). When Congress passed the Arbitration Act in 1925, "it was 'motivated, first and foremost, by a . . . desire' to change the antiarbitration rule." *Terminix*, 115 S. Ct. at 838 (quoting *Dean Witter Reynolds*, 470 U.S. at 220). Based on this policy, this Court has found that state efforts to deny enforcement of certain arbitration agreements are preempted by the FAA. *See Terminix*, 115 S. Ct. 834 (state statute making written, pre-dispute arbitration agreements invalid and unenforceable); *Southland*, 465 U.S. 1 (state statute making agreements to arbitrate certain franchise claims unenforceable); *Perry*, 482 U.S. 483 (state statute making unenforceable private agreements to arbitrate certain wage collection claims).

What neither Congress nor this Court has done, but what petitioners now ask, is to extend FAA preemption to even those minimal state attempts to ensure that parties *know* that the contract they are signing includes an arbitration provision. Thus, petitioners seek preemption even though

Montana's notice requirement does not "stand[] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Volt*, 489 U.S. at 477 (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)). The Montana statute does not prohibit arbitration; instead, it sets out a minimal notice requirement that is easily satisfied. In so doing, it provides a significant benefit to both parties entering an arbitration agreement: it ensures notice to adhering parties and establishes a bright line rule for those designing standardized contracts.

There is nothing in the legislative history of the Federal Arbitration Act that indicates Congress intended to go so far as to prevent states from even enacting requirements to ensure that arbitration agreements are entered knowingly. As this Court has repeatedly held, the pre-emptive effect of a federal statute is fundamentally a question of congressional intent. *See, e.g. Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992); *English v. General Elec. Co.*, 496 U.S. 72, 78-79 (1990); *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). Indeed, where, as here, the field which Congress is said to have preempted includes areas like consumer protection and contract law that have "been traditionally occupied by the States," congressional intent to supersede state laws must be "clear and manifest." *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977). There is no such "clear and manifest" congressional intent to prevent states from enacting even minimal measures, like the Montana notice statute at issue here, that relate to the formation of the arbitration contract itself.

Indeed, the legislative history of the FAA reveals that some members of Congress were concerned about the very problem that the Montana statute seeks to address —

arbitration clauses contained in adhesion contracts. During the hearings on the legislation, members expressed concerns with a law which would enforce an arbitration provision contained in a contract between parties of unequal bargaining power. Senator Walsh cited insurance, employment, construction, and shipping contracts as routinely containing arbitration clauses and being offered on a take-it-or-leave-it basis to captive customers or employees. *Hearing on S. 4213 and S. 4214 before the Subcommittee of the Senate Committee on the Judiciary*, 67th Cong., 4th Sess. 9-11 (1923). He noted that such contracts "are really not voluntarily [sic] things at all" because "there is nothing for the man to do except to sign it; and then he surrenders his right to have his case tried by the court . . . ." *Id.* at 9. Similarly, Senator Sterling expressed concerns about contracts between the railroads and shippers "in which there is an agreement to arbitrate, and the representation is made to the shipper, 'You can take it or leave it, just as you please; but unless you sign you can not ship.'" *Joint Hearings on S. 1005 and H.R. 646 before the Subcommittees of the Committees on the Judiciary*, ("*Joint Hearings*"), 68th Cong., 1st Sess. 15 (1924). Both were assured by the supporters of the bill that it was *not* their intention to cover such cases. *Id.*; *see also Prima Paint Corp.*, 388 U.S. at 414 (1967) (summarizing this legislative history) (Black, J. dissenting).

Indeed, the supporters of the bill downplayed congressional concerns about adhesion contracts by focusing on existing legal protections. For example they pointed out that "[y]ou can not get a provision into an insurance contract to-day unless it is approved by the insurance department." *Joint Hearings* at 15. Clearly, there was no contemplation

that enactment of the FAA would preempt states' ability to regulate arbitration provisions in adhesion contracts, like insurance contracts, in the same manner that other provisions are regulated.

Nonetheless, petitioners argue that the Montana statute is preempted because "it singles out and subjects arbitration agreements to an 'additional limitation under state law' that is not applicable to other contractual provisions." Pet. Brief at 17 (quoting *Southland*, 465 U.S. at 11). Thus, according to petitioners, a state may only require specific disclosure of arbitration provisions if the state requires some additional disclosure for *all* contract provisions — clearly an unworkable scheme. This application of the Act's "equal footing" objective is irrational and is hostile to the objectives of the FAA. Montana does not require particular disclosure of *all* provisions because to do so would not only be impossible, but would defeat the purpose of the special disclosure requirement. Montana requires notice when a party would not otherwise expect a particular provision to be included in a contract; there is no need to provide front-page notice for expected terms like price, service, or credit. Exempting arbitration provisions from *minimal* notice requirements places arbitration agreements on a footing well above other contract terms, contrary to the intent of Congress. *See Volt*, 489 U.S. at 478, (quoting *Prima Paint*, 388 U.S. at 404 n.12 (1967)) (Act was designed "to make arbitration agreements as enforceable as other contracts, but not more so").

In an attempt to demonstrate that Montana's notice statute is contrary to the purposes of the FAA, petitioners manufacture an argument that Montana is hostile to arbitration. Pet. Brief at 17-18. Yet, Montana is not a state

that refuses to enforce arbitration agreements that are knowingly entered. Quite the contrary, in its 1985 reform legislation, the Montana legislature moved state law in a modern pro-arbitration direction, providing for the full enforcement of arbitration agreements that are knowingly entered. And the Montana Supreme Court has followed the legislature's directives in this regard, repeatedly rejecting attempts to invalidate arbitration agreements in the years since this Court's decision in *Southland*, 465 U.S. 1, and Montana's Uniform Arbitration Act was enacted. *See Chor v. Piper, Jaffray & Hopwood, Inc.*, 862 P.2d 26 (Mont. 1993); *Downey v. Christensen*, 825 P.2d 557 (Mont. 1992); *Vukasin v. D.A. Davidson & Co.*, 785 P.2d 713 (Mont. 1990); *William Gibson Jr., Inc. v. Graff Communications*, 780 P.2d 1131 (Mont. 1989); *Larsen v. Opie*, 771 P.2d 977 (Mont. 1989); *Passage v. Prudential-Bache Secs., Inc.*, 727 P.2d 1298 (Mont. 1986).

Only twice in the last decade has the Montana Supreme Court invalidated an arbitration provision in a contract.[8] First, in *Mueske v. Piper, Jaffray & Hopwood, Inc.*, 859 P.2d 444 (Mont. 1993), the court invalidated an arbitration provision because the clause incorporated the rules of NYSE and NASD as controlling law, yet failed to follow the disclosure requirements of those rules. *Id.* at 450. Consistent with this Court's directive in *Volt*, 489 U.S. 468, the *Mueske* court applied "the general rules of contract interpretation" and held that "the validity of the arbitration

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[8]In one other case, the Montana court refused to compel arbitration because the arbitration clause applied prospectively while the dispute at issue occurred before the arbitration agreement was signed. *See Frates v. Edward D. Jones & Co.*, 760 P.2d 748 (Mont. 1988).

clause be determined according to the incorporated controlling law — the NYSE and NASD rules — unless such rules contravene the substantive law of the FAA." 859 P.2d at 450. The *Mueske* decision was clearly dictated by *Volt*, in which this Court upheld the application of a state arbitration rule, which had been incorporated into an arbitration agreement via a choice-of-law provision, "even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward." *Volt*, 489 U.S. at 479. The only other time the Montana court has invalidated an arbitration agreement is in the instant case, where DAI failed to follow the statutory notice requirement. These two instances are hardly evidence of a judicial hostility to arbitration agreements that the FAA was designed to eliminate.

Petitioners also argue that permitting states to require specific notice of arbitration agreements will significantly disrupt the transaction of interstate commerce and impose additional business costs. Pet. Brief at 23-29. Contrary to petitioners' argument, however, the FAA does not mandate and was not designed to promote uniformity that would allow those involved in negotiating interstate agreements to ignore the requirements of local law.

Moreover, because the industries affected by such mandatory notice provisions are often highly regulated by the states, the claim that the Montana notice requirement establishes more than a trivial burden is implausible. Sophisticated market participants transacting business in multiple states already are obliged to adapt their form contracts, franchise agreements, leases, insurance policies, or securities registrations to the specific requirements of diverse jurisdictions. For example, beginning with the enactment of the California Franchise Investment Law in 1971, fourteen

states have adopted statutes requiring franchise registration and prospectus-type disclosure. These provisions are similar, *but not identical*, to that of California.[9] Thus, in drafting franchise agreements, franchisors must already take into account differing requirements based on the laws of each state in which they are transacting business. *See* Practicing Law Institute, *Franchising* 50 (1992). As a practical matter, counsel for franchisors must pay "careful attention . . . to strict compliance with state franchise registration and disclosure statutes." *Id.* Moreover, "careful attention must be paid to the jurisdictional scope of franchise laws and the transactions they cover." *Id.*

The securities industry faces dual regulation by both the federal government and the states. Every state has enacted a securities act, often referred to as "blue sky" laws,

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[9] *See* California Franchise Investment Law, Cal. Corp. Code, §§ 31000—31516 (West Supp. 1996); *see also* Hawaii Franchise Investment Law; Haw. Rev. Stat., §§ 428-E1—428E-12 (1995); Illinois Franchise Disclosure Act, 815 ILCS §§ 705/1, *et seq.* (1996); Ind. Code Ann. §§ 23-2-2.5-47, *et seq.* (Burns 1995); Md. Bus. Reg. Code Ann. §§ 14-102—14-233 (1995); Michigan Franchise Investment Law, Mich. Stat. Ann. §§ 19.854(1)—(46) (1994); Minn. Stat. §§ 80C.01—80C.14 (1995); New York Gen. Bus. Law, §§ 680—684 (Consol. 1995); North Dakota Franchise Investment Law, N.D. Cent. Code Ann., §§ 51-19-01—51-19-17 (1995); Rhode Island Franchise Investment Act, R.I. Gen. Laws, §§ 19-28.1-1—19-28.1-34 (1995); South Dakota Franchises for Brand-Name Goods and Services Law, S.D. Codified Laws Ann., §§ 37-5A-1—37-5A-87 (1995); Texas Business Opportunity Law, Tex. Rev. Civ. Stat. Ann. art. 5069-16.01 (West 1996); Virginia Retail Franchising Act, Va. Code Ann. §§ 13.1-557—13.1-574 (1995); Washington Franchise Protection Act, Wash. Rev. Code §§ 19.100.010, *et seq.* (1995); Wisconsin Franchise Investment Law, Wisc. Stat. §§ 553.01—553.78 (1994).

regulating securities distribution and broker-dealer activities. Thomas Lee Hazen, *The Law of Securities Regulation* 328 (2d ed. 1990). Many states also regulate tender offers and activities of investment advisers. *Id.* "The various state laws differ significantly from one another." *Id.* While thirty-nine jurisdictions have adopted the 1956 Uniform Securities Act, there is still considerable variation particularly concerning registration requirements. *See, e.g.*, Cal. Corp. Code §§ 25000-25804; N.Y. Gen. Bus. Law §§ 352-359-h.

Similarly, any contention that the insurance industry requires national uniform standards to operate effectively in interstate commerce is not credible. "Administrative regulation of insurance has been and continues to be primarily the responsibility of state authorities rather than the federal government." Robert E. Keeton & Alan I. Widiss, *Insurance Law* § 8.1(a), at 930 (1988). In fact, insurance industry lobbyists played a key role in the enactment of state statutes to avoid the regulatory authority otherwise available under the McCarran-Ferguson Act, 15 U.S.C. § 1012. *Id.* at 931-32. Every state has adopted legislation regulating insurance transactions and companies and has designated a state administrative officer (usually characterized as a commissioner of insurance) to supervise the forms of insurance organizations, their financial stability, the terms of policy forms, licensing provisions, and mechanisms for ensuring insurer liquidity or rehabilitation in case of insolvency. *Id.*, § 8.2(b), at 940. There is enormous variation among states in their regulation of insurance transactions including extensive, mandatory proscriptions of

notice and disclosure provisions in state-approved policies.[10] Even within a given state, insurers must conform policies according to the class of insurance.[11] Moreover, though insurance companies may typically use standard forms offering a limited number of options, the standardization of forms through state-mandated language and disclosures has been a deliberate state legislative and administrative response to deal with the concern that insurance contracts present the problems of the "prototypical" adhesion contract. *See* Keeton & Widiss, *supra*, § 2.8(a), at 120 n.2

Against this backdrop of differing state requirements, any claim that the simple arbitration notice required by Montana would seriously disrupt business is clearly exaggerated. Indeed, it is easier for nationwide businesses to comply with a statutory requirement than to guess what the common law would require.

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[10] *See, e.g.*, Cal. Ins. Code § 332 (1995) (general disclosures); New York Ins. Law § 3404 (1995) (fire insurance policy); Minn. Stat. § 60A.207 (1995) (notice of surplus lines insurance act); Mich. Comp. Laws § 550.1410a (1994) (provisions for group certificates under Nonprofit Health Care Corporation Reform Act).

[11] *See, e.g.*, Cal Ins. Code § 778.4 (disclosures re fire and casualty broker-agents); *Id.*, 779.14 (rights to rescind credit life and disability insurance); *Id.*, § 10086 (earthquake insurance); *Id.*, § 10127.11 (life insurance policies for senior citizens), *Id.*, § 10127.8 (advertisements for term life insurance directed to individuals ago fifty-five and older); *Id.*, § 10194.7 (supplemental Medicare disclosure); *Id.*, § 11580.1 (disclosure for motor vehicle insurance).

CONCLUSION

For the foregoing reasons, the judgment of the Supreme Court of Montana should be affirmed.

Respectfully submitted,

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March 15, 1996

No. 95-559

IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,
Petitioners,

v.

PAUL CASAROTTO, ET UX.,
Respondents.

On Writ of Certiorari to the Supreme Court of Montana

REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

Not satisfied with the reasoning of the Montana Supreme Court, or even with their own arguments to that court, respondents now offer two newly crafted arguments in support of the decision below. They no longer maintain, as the Montana Supreme Court did in each of its opinions, that *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), narrowed the preemptive scope of Section 2 of the Federal Arbitration Act ("FAA") to permit states to impose additional requirements for the enforcement of arbitration agreements. App. 26. As respondents appear belatedly to recognize, *Volt* did not redefine the grounds for enforcing an arbitration agreement under Section 2, and thus that decision does not support the Montana Supreme Court's refusal to enforce the parties' agreement to arbitrate.

Accordingly, respondents devote most of their brief to an effort to fit the Montana notice statute directly into

the text of Section 2, which provides that written arbitration agreements involving interstate commerce are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Respondents' newly found argument proceeds in two steps. They first claim that Montana may, under its common law relating to adhesion contracts, invalidate arbitration clauses contained in standardized contracts because arbitration agreements are "unexpected" unless conspicuously disclosed. Resp. Br. at 24. Respondents then claim that Montana's notice statute merely codifies, and is a "particularized application" of, this supposed common law principle that would have allowed the Montana courts "to invalidate the arbitration provision in this case and in others as well." *Id.* Accordingly, respondents argue, the notice statute falls within Section 2's savings clause as a ground for "revocation of any contract."

Respondents' new arguments are as unavailing as their original ones. First, even if respondents were correct that the notice statute merely codifies Montana's common law relating to adhesion contracts, this Court has made it clear that, as a matter of federal law, a court may not rely upon the uniqueness of an agreement to arbitrate, and a state's suspicion of that method of dispute resolution, as a basis for a state law holding that enforcement of the arbitration agreement is unconscionable or "adhesive." And this is true whether the court is applying a state's statute, such as the notice statute, or its common law. Permitting courts to refuse enforcement of arbitration agreements unless they are more prominently highlighted than other terms of a standardized contract on the ground that arbitration is "unexpected" would wholly eviscerate Congress's intent to place arbitration agreements on the same footing as other contracts. Second, even if the FAA somehow permitted a state to invalidate arbitration agreements on the ground that they are "unconscionable" or "unexpected" unless they are conspicuously disclosed in

standardized contracts, the statute here goes far beyond any such principle, invalidating *all* arbitration agreements not meeting unique conditions—regardless of the circumstances of the agreement or the relative bargaining power of the parties.

Inevitably, therefore, respondents must argue that even though Montana's notice law is not a ground for revocation of contracts generally, the FAA nevertheless does not preempt state laws intended to provide "notice" of an arbitration provision to persons deemed in need of special protection. Beyond the obvious fact that Montana's law is not so limited, respondents have advanced no arguments that would warrant this Court overruling its numerous decisions holding that enforcement of arbitration agreements is a matter of federal law and that the broad principle of enforceability embodied in Section 2 is not subject to *any* limitations under state law.

I. MONTANA'S ARBITRATION NOTICE STATUTE IS NOT A GROUND FOR THE REVOCATION OF ANY CONTRACT WITHIN THE MEANING OF SECTION 2.

A. This Court has acknowledged "that a party may assert *general* contract defenses such as fraud to avoid enforcement of an arbitration agreement" under the savings clause of Section 2. *Southland Corp. v. Keating*, 465 U.S. 1, 16 n.11 (1984) (emphasis added). However, this Court has also made it clear in numerous decisions that a state may apply its laws to an agreement to arbitrate only "*if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." *Perry v. Thomas*, 482 U.S. 483, 493 n.9 (1987); *see Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834, 843 (1995); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 33 (1991); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987). Thus, a "state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue

does not comport with [the] requirement[s] of § 2." *Perry*, 482 U.S. at 493 n.9. By its plain language, the FAA preempts *any* state-law precept that makes arbitration agreements any less enforceable, less valid, or less irrevocable than other contract terms. *See Terminix*, 115 S. Ct. at 843; *see generally* Petr. Br. at 12-19.[1]

To convince this Court that Montana's notice statute is, in fact, a ground for the revocation of any contract, respondents seek to argue, first, that the parties' agreement to arbitrate would be void under Montana's general common law relating to adhesion contracts and, second, that Montana's notice statute merely "codifies" this common law principle. Resp. Br. at 24. At the outset, it bears noting that the trial court rejected respondents' argument below that the parties' arbitration agreement in this case violated Montana's common law of adhesion; that respondents then abandoned that argument on appeal in favor of their claim that petitioners failed to comply with the mandatory requirements of Montana's notice statute;[2] and that neither of the opinions of the Montana Supreme Court below ever even mentioned the purported common law principles of adhesion now proffered by respondents, let alone suggested that the parties' agreement in this case was void under Montana's common law.

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[1] Thus, the leading treatise on the FAA observes that "a state law singling out arbitration for more restrictive treatment than does its general contract law violates *Prima Paint . . .*; *Southland . . .* ; and *Perry. . . .*" 2 I. Macneil, et al., *Federal Arbitration Law* § 10.8.1, at 10:69 n.19 (1995) (citations omitted) (hereinafter *Federal Arbitration Law*).

[2] Respondents made a common law adhesion contract argument to the trial court in their February 12, 1993 brief, and supported that argument with an affidavit by respondent Paul Casarotto (App. 86-87). By ordering arbitration, the trial court implicitly rejected the argument, and respondents then abandoned their common law defense on appeal. (Appellants' Briefs, filed Dec. 2, 1993, Feb. 8, 1994, and Apr. 8, 1994); *see Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 216 n.2 (1985).

Nevertheless, even if one assumes *arguendo* that Montana's notice statute is identical to its common law, that fact would not supply a different answer to the question posed by this petition. The same principles of federal law that are set forth in petitioners' main brief would also prevent Montana from refusing to enforce the parties' arbitration agreement under its common law on the ground that a perfectly ordinary agreement to arbitrate in a standardized contract, such as the one involved here, is "unconscionable," "adhesive" or "unexpected." Under the FAA, Montana courts may not, as respondents urge, make a virtue out of that state's century-old refusal to enforce arbitration agreements,[3] and its desire to preserve access to its courts, by deciding that arbitration agreements are as a class especially "unexpected" or "important" and therefore unenforceable unless displayed more conspicuously than the other terms in a contract. It makes no difference whether such a public policy emanates from the state legislature, as in the case of the notice statute, or from judicial development of common law principles. *Perry*, 482 U.S. at 492 n.9. For arbitration agreements within its scope, the FAA makes any state policy disfavoring arbitration agreements unlawful, "for that kind of policy would place arbitration clauses on an unequal 'footing,' directly contrary to the Act's language and Congress's intent." *Terminix*, 115 S. Ct. at 843; *see Moses H. Cone Memorial Hosp. v. Mercury Constr. Co.*, 460 U.S. 1, 24 (1983).

In *Perry v. Thomas*, 482 U.S. 483 (1987), the Court made this point quite clear. There, the party seeking to be relieved of his arbitration obligation similarly argued that his arbitration agreement constituted an "unconscion-

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[3] Montana was one of the last states to adopt some form of arbitration law in 1985, in the wake of *Southland*. *See* Montana Senate Judiciary Comm. minutes at 6 (Jan. 21, 1985), lodged by respondents with the Court. Even then, Montana enacted several deviations from the Uniform Arbitration Act. *See* Petr. Br. at 17 n.9.

able, unenforceable contract of adhesion" under California's common law. 482 U.S. at 492-93 n.9. In discussing this common law argument, the Court emphasized that a state-law principle, "whether of legislative or judicial origin," that took its meaning precisely from the fact that an agreement to arbitrate was at issue does not comply with the savings clause of Section 2, because that clause is limited to grounds that exist for the revocation of "contracts generally." *Id.* Thus, even though in theory any contract provision might be held to be "unconscionable," the Court instructed that "[a] court may [not] rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what we hold the state legislature cannot." *Id.; accord Southland*, 465 U.S. at 16 n.11.

Just last Term, this Court in *Terminix* reaffirmed this construction of Section 2. The Court declared in no uncertain terms that under the savings clause of Section 2, "[s]tates may not [] decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause." *Terminix*, 115 S. Ct. at 843. "[A]ny such state policy [is] unlawful . . . ." *Id.*

If, therefore, as respondents now claim, Montana courts always, or even presumptively,[4] invalidate arbitration

[4] As construed by respondents, Montana's law replaces the federal presumption in favor of arbitration with a state presumption against arbitration. However, the FAA establishes, as a matter of federal law, that any doubts concerning arbitrability "'should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay or like *defenses to arbitration.*'" *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct., 1212, 1218 n.8 (1995) (emphasis added) (quoting *Moses H. Cone*, 460 U.S. at 24-25); *see First Options of Chicago, Inc. v. Kaplan*, 115 S. Ct. 1920, 1924 (1995). "[B]y skewing the otherwise hospitable inquiry into arbitrability," the Montana law stands in direct conflict with Section 2. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 627 (1985).

agreements contained in standardized contracts as "unexpected" unless they are more prominently disclosed than the other terms of the contract, that state-law principle would violate the express terms of Section 2 and the clear teachings of *Southland*, *Perry* and *Terminix*. For such courts would, then, be applying a state-law principle that took its meaning solely from the fact that the subject matter of the term claimed to be "unexpected" is an agreement to arbitrate.

There is no reason why *Perry*'s holding regarding the impact of the FAA on a state's application of its law of unconscionability should have any less force when a state seeks, instead, to invalidate an arbitration clause based upon its common law relating to adhesion contracts. Inevitably, both doctrines reflect value judgments that are made about what types of agreements courts will and will not enforce. *See* Restatement (Second) of Contracts § 211 cmt. F (adhesion principles are "closely related to the policy against unconscionable terms"). Montana courts surely would not refuse to enforce a term in a standardized agreement that was considered to be favorable to a franchisee, or a term in a contract of adhesion that provided for litigation of all disputes in the courts—even if such terms were not "conspicuously" disclosed. 3 L. Cunningham et al., *Corbin on Contracts* § 559A, supp. 374 (1994) ("what courts aim at doing is distinguishing good adhesion contracts which should be enforced from bad adhesion contracts which should not").[5]

[5] Under ordinary common law principles, courts do not always or even usually invalidate the provisions of a contract of adhesion. *Corbin on Contracts* § 559A, at supp. 374. "Thus, a contract of adhesion is fully enforceable according to its terms unless certain other factors are present which, under established legal rules—legislative or judicial—operate to render it otherwise." *Graham v. Scissor-Tail, Inc.*, 623 P.2d 165, 172 (Cal. 1981) (citations omitted). Comment F to Section 211 of the Restatement (Second)

Therefore, if, as respondents claim, Montana courts invalidate arbitration agreements contained in standardized contracts as "unexpected" unless they are "conspicuously" disclosed, they must do so precisely because the clause in question involves arbitration. Yet, Section 2 prohibits states from making value judgments about whether to enforce arbitration agreements—under either the doctrine of unconscionability or adhesion—that rely upon the fact that an agreement to arbitrate in particular is at issue. *See, e.g., Terminix,* 115 S. Ct. at 843; *Perry,* 482 U.S. at 492-93 n.9; *Southland,* 465 U.S. at 16 n.11; *see also Mitsubishi,* 473 U.S. at 628; *cf. American Airlines, Inc. v. Wolens,* 115 S. Ct. 817, 826 n.8 (1995) (state law contract principles may be preempted to the extent they seek to effectuate a state public policy, rather than the intent of the parties).

Accordingly, lower courts have consistently rejected arguments, like those made by respondents, that have sought to justify statutory regulation of arbitration, through notice or similar requirements, on the ground that a state could instead impose the same requirements under the state's common law of adhesion. Expressly relying on this Court's decision in *Perry*, the First Circuit in *Securities Industry Ass'n v. Connolly,* 883 F.2d 1114 (1st Cir. 1989), *cert. denied,* 495 U.S. 956 (1990), explained:

> Massachusetts could also pass legislation declaring all contracts of adhesion presumptively unenforceable. Such a rule would apply to arbitration agreements, *among others.* But Massachusetts may not say (judicially, legislatively, or in a regulatory mode) that "adhesion contracts are especially bad when arbitration is included, so we will therefore ban, or place gyves and shackles upon, only those adhesive contracts which contain arbitration clauses."

of Contracts describes the circumstances under which courts will invalidate "unexpected" terms in a contract of adhesion as limited to "bizarre or oppressive" terms or terms that "eliminate[] the dominant purpose of the transaction."

> That kind of value judgment is foreclosed precisely because the FAA ordains that the state's appulse toward arbitration agreements must be the same as its approach to contracts generally.

Id. at 1121.[6] Similarly, in *Saturn Distribution Corp. v. Williams,* 905 F.2d 719 (4th Cir.), *cert. denied,* 498 U.S. 983 (1990), the Fourth Circuit held:

> If Virginia uniformly barred the formation of nonnegotiable contractual terms or declared all contracts of adhesion to be presumptively unenforceable, then the statute at issue would not be at odds with general contract law. . . . However, . . . Virginia does not always, or even usually, presume adhesive contracts to be unenforceable. Instead, Virginia adheres to the general rule that: "The use of a standard form contract between two parties of admittedly unequal bargaining power does not invalidate an otherwise valid contractual provision". . . .
>
> Thus, we hold that the statute is preempted because, as in *Southland*, it treats arbitration agreements more harshly than other contracts. . . .

Id. at 725-26.[7]

[6] The court in *Connolly* went on to observe: "Although any fraudulent, adhesive, or economically coerced agreement to arbitrate would be challengeable, the Supreme Court has suggested that such challenges must not only be brought on grounds common to contracts generally, but must also be proven on the facts of the individual case, not automatically shunted to one side according to practices governing the formation of arbitration agreements as a class of contracts." 883 F.2d at 1121 n.5 (citing *Rodriguez de Quijas v. Shearson/American Express, Inc.,* 490 U.S. 477, 484 (1989)).

[7] Likewise, it is irrelevant that Montana law may also require certain types of installment contracts to include conspicuous notice of particular rights or omissions. *See* Resp. Br. at 5. Such "specialized provisions applicable only to certain types of contracts do not form a cohesive general law or pattern of laws applicable to most contracts," as contemplated by Section 2's savings clause. *Saturn,* 905 F.2d at 726 n.5; *see Southland,* 465 U.S. at 16 n.11.

Finally, to accept respondents' argument that courts may use common law principles of adhesion to deny enforcement of arbitration agreements, but not other terms, in standardized contracts would open a gaping hole in the fabric of national uniformity that Congress sought to create in enacting the FAA. After all, Congress passed the FAA to overcome judicial reluctance to enforce arbitration agreements. *Terminix*, 115 S. Ct. at 839; *McMahon*, 482 U.S. at 225; *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 510-11 (1974). Courts should, therefore, "be on guard for artifices in which the ancient suspicion of arbitration might reappear." *Connolly*, 883 F.2d at 1119; *see McMahon*, 482 U.S. at 226; *Moses H. Cone*, 460 U.S. at 24-25. If a state like Alabama, whose statutory ban on pre-dispute arbitration was found to be preempted in *Terminix*, could perpetuate a public policy suspicious of arbitration by having its courts simply declare pre-dispute arbitration agreements (but no other terms) in standardized contracts to be "unconscionable," "adhesive" or "unexpected," it would be able to achieve through its common law that which this Court has explicitly held it may not do by statute. *See Terminix*, 115 S. Ct. at 843; *Perry*, 482 U.S. at 493 n.9; *Southland*, 465 U.S. at 16 n.11. Because the FAA makes any such state policy, whether of legislative or judicial origin, unlawful, *see Terminix*, 115 S. Ct. at 843, respondents' claim that Montana's notice statute merely embodies its common law does not save the statute from preemption by the FAA.

B. Respondents also fail in their recent effort to recast the notice statute as merely a codification of Montana's common law relating to adhesion contracts.[8] As an initial matter, it is abundantly clear from the face of the notice statute itself that this law has nothing to do with

[8] Neither in their briefs in the Montana Supreme Court nor in their two oppositions to certiorari before this Court did respondents ever suggest that Montana's notice statute codified that state's common law of adhesion.

Montana's common law of adhesion, which undoubtedly is why the Montana Supreme Court in its multiple opinions below explaining this statute never once mentioned the phrase "adhesion contract," let alone discussed Montana's common law of adhesion.[9] By its plain language, the Montana statute bars enforcement of the arbitration term of every contract that omits the precise form of notice prescribed by the statute, regardless whether the term was bargained-for or non-negotiable; whether arbitration was unusual or expected; whether the transaction involved two corporations of equal bargaining power or a consumer; or whether the clause was specifically discussed and explained, or (as here) was read by each of the parties. *See supra* n.6. Thus, the Montana Supreme Court voided the parties' agreement to arbitrate without regard to any facts other than the fact that the franchise agreement did not have the prescribed notice. To the extent, therefore, that respondents' arguments are founded on the notion that Montana enacted this statute to provide special protections for particular categories of parties or types of contracts, they are obviously off the mark.

Respondents are equally wrong in their claim that a neutral application of Montana's general common law relating to adhesion contracts would void the parties' arbitration agreement in this case. There is nothing remarkable about this transaction or the arbitration term itself (which is a typical arbitration provision) that would cause a court in Montana or anywhere else to invalidate the parties' arbitration agreement as an invalid contract of adhesion.

[9] That the Montana Supreme Court does not share respondents' novel construction of the notice statute is also borne out by the court's analysis of the choice of law issue. The Montana Supreme Court voided the parties' choice of Connecticut law, not on the basis of Montana's common law policies regarding adhesion contracts, but rather because of a public policy, evidenced by the notice statute, that is suspicious of arbitration as potentially inconvenient, expensive and devoid of the procedural safeguards attendant to judicial proceedings. App. 20-21.

Certainly, the presence of a dispute resolution clause is hardly unexpected in a franchise agreement.[10] As is true of so many commercial transactions today, "no franchise structure would be complete without providing for what happens in the event of a dispute between the franchisor and its franchisees. . . . [A]rbitration or litigation must be specified." David J. Kaufman, *An Introduction to Franchising and Franchise Law*, in *Franchising 1992: Business and Legal Issues* 9, 41 (Practising Law Inst. ed., 1992).[11] Thus, commentators have observed that "the theory underlying judicial refusal to enforce adhesion contracts—that the offeror does not expect the offeree to read and be familiar with them—is not consistent with the disclosure obligations imposed upon franchisors, the size and seriousness of the business transaction, and the extent of the responsibilities to be undertaken by the

[10] Indeed, Mr. Casarotto had considerably more disclosure of contract terms than is the case with most commercial contracts because DAI complied with its disclosure requirements under the Federal Trade Commission's ("FTC") Franchise Rule, 16 C.F.R. Part 436. *See generally* Lydia B. Parnes, *Federal Trade Commission Regulation of Franchising*, in *Franchising 1992: Business and Legal Issues* 99 (Practising Law Inst. ed., 1992). DAI's franchise offering circular informed Mr. Casarotto of the arbitration provision and gave him a written notice from the FTC of the need to read the contract carefully and to review it with a business advisor such as a lawyer. Petr. Br. at 4 n.3; App. 62-63. Mr. Casarotto received two copies of the offering circular, the first, two months before he signed the franchise agreement, and the second, two weeks before he signed. Appendix to Appellees' Br., Exh. 1 (between p. 10 and p. 11), filed Jan. 14, 1994, in the Montana Supreme Court.

[11] Paul Casarotto admits that "I read the agreement over before I signed it." App. 87. While he claimed in the trial court—before abandoning his adhesion contract argument on appeal—that he did not appreciate the meaning of the arbitration clause or realize that he was waiving his right of access to court, *id.*, there is no general state-law principle requiring a franchisor to explain the meaning of a contract term to a franchisee. *See e.g., Chor v. Piper, Jaffray & Hopwood, Inc.*, 862 P.2d 26, 30 (Mont. 1993); *Brill v. Catfish Shaks of America, Inc.*, 727 F. Supp. 1035, 1039 n.6 (E.D. La. 1989).

franchisees." 2 W. Michael Garner, *Franch. & Distr. Law & Prac.* § 8:27 (1990) (footnote omitted).

Courts have, therefore, repeatedly recognized that arbitration clauses are to be expected in franchise agreements and similar business relationships involving standard-form contracts.[12] Thus, in *Keating v. Superior Court*, 645 P.2d 1192 (Cal. 1982), *rev'd on other grounds, Southland Corp. v. Keating*, 465 U.S. 1 (1984), a class action involving 7-Eleven franchisees, the California Supreme Court observed that arbitration of disputes, even those relating to a franchise relationship set forth in a contract of adhesion, "is generally considered to be a mutually advantageous process," and that "provision for arbitration in a commercial context is quite common, and reasonably to be anticipated." *Id.* at 1198.[13]

[12] *See, e.g., Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989) ("standard customer agreement"); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) ("Uniform Application for Securities Industry Registration"); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985) (standard "Distributor Agreement"); *Southland Corp. v. Keating*, 465 U.S. 1 (1984) (standard franchise agreement). The Restatement (Second) of Contracts accepts and even applauds the utility of standardization, *see id.* § 211 cmt. a, and it is widely acknowledged that "standardization, uniformity in the operation of the system, and the opportunity to learn how to run a business are what the franchisee pays for, and these benefits cannot exist without standardized terms enforceable upon all units in the system." Garner, *Franch. & Distr. Law & Prac.* § 8:27.

[13] *See, e.g., Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer*, 115 S. Ct. 2322, 2325 (1995) (shipping agreement); *McMahon*, 482 U.S. at 227 (brokerage agreement); *David L. Threlkeld & Co. v. Metallgesellschaft Ltd.*, 923 F.2d 245, 249 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991) (trading agreement).

Indeed, the revocation of an arbitration clause as outside a party's "reasonable expectations" is virtually unprecedented. *See generally* 2 *Federal Arbitration Law* § 19.3.3. Respondents can cite only two cases that have voided arbitration provisions in adhesion contracts, neither of which dealt with a commercial transaction. *See* Resp. Br. at 19-20. *Broemmer v. Abortion Services of Phoenix,*

The Montana Supreme Court itself has recognized that arbitration clauses in nonnegotiable standardized contracts are "common" and are not considered unexpected as a matter of Montana's common law. *Passage v. Prudential-Bache Sec., Inc.*, 727 P.2d 1298, 1301-02 (Mont. 1986) (enforcing arbitration clause in fourteenth paragraph of broker's customer agreement form, in same typeface as other clauses), *cert. denied*, 480 U.S. 905 (1987). Thus, federal and state courts in Montana have enforced arbitration agreements contained in standardized franchise contracts.[14] Indeed, in *Chor v. Piper, Jaffray & Hopwood, Inc.*, 862 P.2d 26 (Mont. 1993), the Montana Supreme Court rejected a common law contract of adhesion defense that was founded on testimony virtually identical to Casarotto's claim in this case—that Chor "did not fully understand the legal impact" of an arbitration provision she had read. Consistent with the law generally, the Montana court held that "a party cannot avoid the legal consequences of an agreement simply by later claiming that she did not understand the impact of the plain language of the contract on her legal rights." *Id.* at 30; *see also Vukasin v. D.A. Davidson & Co.*, 785 P.2d 713, 715

Ltd., 840 P.2d 1013 (Ariz. 1992), was not decided under the FAA, and contrary to respondents' arguments here, it rejected "the invitation to attempt to establish some 'bright-line' rule of broad applicability." *Wheeler v. St. Joseph Hospital*, 133 Cal. Rptr. 775 (Cal. Ct. App. 1976), also was not decided under the FAA. Not only did the court rely on a viewpoint contrary to the FAA—that the patient "forfeit[ed] a valuable right" by agreeing to arbitrate, *id.* at 786—it also contrasted the hospital setting to commercial contracts where the presence of a dispute resolution clause, including an arbitration agreement, is reasonably to be expected. *Id.* at 786-88 & n.12.

[14] *See King v. Postal Annex, Inc.*, CV-94-011-GF (D. Mont. Dec. 14, 1995) (franchise agreement); *Snap-On Tools Corp. v. Vetter*, 838 F. Supp. 468 (D. Mont. 1993) (dealership agreement from 1990); *Downey v. Christensen*, 825 P.2d 557 (Mont. 1992) (donut shop franchise agreement from 1987).

(Mont. 1990) (rejecting similar claim); *Larsen v. Opie*, 771 P.2d 977, 978 (Mont. 1989) (same).[15]

Contrary to respondents' claim, therefore, the parties' arbitration agreement in this case would be fully enforceable under general principles of Montana's common law—unless, of course, Montana were to alter that law so as to make arbitration agreements less enforceable than other contractual provisions. As a consequence, respondents and the Montana Supreme Court (led by the dissenter in *Chor*) turned to the only avenue left to invalidate the parties' agreement to arbitrate—a specialized notice statute that places agreements to arbitrate on a different footing from other contract terms. That statute, however, as we have explained, is in direct and irreconcilable conflict with Section 2 of the FAA.

II. THE FEDERAL ARBITRATION ACT PREEMPTS STATE-LAW LIMITATIONS ON ENFORCING ARBITRATION AGREEMENTS.

Finally, respondents ask this Court to imply a new exception to Section 2 on the ground that the FAA should not preempt "state attempts to ensure that parties *know* that the contract they are signing includes an arbitration provision." Resp. Br. at 25. As petitioners demonstrated in their main brief, however, this Court has previously rejected identical invitations to undercut the nationwide uniformity that Congress sought to achieve in enacting the FAA. Petr. Br. at 13-18. Respondents provide no compelling reason to depart from that established precedent here.

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[15] There is also no cause for this Court to assume, as respondents do, that when he decided to enter the sandwich shop business, Mr. Casarotto could not have found another franchisor that did not require arbitration or could not simply have operated a sandwich business without seeking the benefits of a franchise arrangement, and thereby have avoided a provision that he apparently now finds disagreeable. *See Rodriguez de Quijas*, 490 U.S. at 484; *Leibrand v. National Farmers Union Prop. & Cas. Co.*, 898 P.2d 1220, 1227 (Mont. 1995); *Chor*, 862 P.2d at 30.

In enacting the FAA, Congress sought broadly to overcome judicial and legislative hostility to arbitration. *Terminix*, 115 S. Ct. at 839; *Scherk*, 417 U.S. at 510-11. To that end, Congress chose to make its own assessment of when agreements to arbitrate will be enforced, "unencumbered by state-law constraints." *Southland*, 465 U.S. at 13. The congressional policy of "rigorously enforc[ing] agreements to arbitrate," *Dean Witter Reynolds*, 470 U.S. at 221, is reflected in the minimal requirements imposed by the FAA—that the agreement to arbitrate be part of a written contract evidencing a transaction involving interstate commerce and that it be irrevocable except upon grounds for the revocation of any contract. Because "Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements," this Court has recognized that the FAA's "broad principle of enforceability is [not] subject to any additional limitations under state law." *Southland*, 465 U.S. at 11, 16; *see Perry*, 482 U.S. at 489.[16]

Congress, therefore, left no room for "a state policy of providing special protection for franchisees," consumers or any other group. *Southland*, 465 U.S. at 17 n.11 (internal quotation marks omitted); *see Mitsubishi*, 473 U.S. at 628; 2 *Federal Arbitration Law* § 19.1.1., at 19:4-5 (under *Southland* and *Perry* "state legislation requiring greater information or choice in the making of agreements to arbitrate than in other contracts is preempted"). Accordingly, this Court has repeatedly enforced

[16] Respondents never quote or even cite the governing passages in *Perry* and *Southland*, choosing instead to argue on the basis of legislative history cited in a dissenting opinion and general principles of preemption and to ignore this Court's already abundant jurisprudence on the scope of the FAA. *See* Resp. Br. at 26-28. It is clear from the Senate Hearing cited by respondents that Congress added Section 1 of the FAA to address the concerns quoted in respondents' brief. *Hearing on S. 4213 and S. 4214 before the Subcommittee of the Senate Committee on the Judiciary*, 67th Cong., 4th Sess. 9 (1923); *see Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 402-03 n.9 (1967).

arbitration clauses in cases involving standardized agreements and unequal bargaining power, even in cases involving consumers. *See, e.g., Terminix*, 115 S. Ct. at 483; *Gilmer*, 500 U.S. at 35; *Rodriguez de Quijas*, 490 U.S. at 484; *Southland*, 465 U.S. at 16-17; *see also Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 590 (1991) (forum selection clauses contained in "three pages of fine print"). Special protection from arbitration agreements, if any truly is needed, must come from Congress, not state legislatures or courts. *McMahon*, 482 U.S. at 226; *Mitsubishi*, 473 U.S. at 627.

Not only are respondents unable to harmonize their position with the language of Section 2 and this Court's decisions under that section, but they also are unable to reconcile their desire to let each state set its own requirements for enforcing arbitration agreements with the national uniformity contemplated by Section 2. *See* Petr. Br. at 23-29; *see also Terminix*, 115 S. Ct. at 843-44 (O'Connor, J., concurring) ("my agreement with the Court's construction of § 2 rests largely on the wisdom of maintaining a uniform standard"). They emphasize that "[s]ophisticated market participants transacting business in multiple states" must already adhere to a wide array of state-specific requirements. Resp. Br. at 30-33. However, respondents say nothing about whether the laws they cite affect the enforceability of arbitration agreements, an area governed by a *federal* law that was motivated by a desire for nationwide uniformity. *Terminix*, 115 S. Ct. at 838-40; *Southland*, 465 U.S. at 12; *Perry*, 482 U.S. at 492 n.9.[17]

With respect to arbitration, the only variation in state laws that Congress determined that interstate businesses need be concerned with are the differences that might

[17] Surprisingly, respondents rely upon the same California franchise statute that this Court found preempted in *Southland* as an example of how companies must cope with varying state regulatory schemes. Resp. Br. at 31 n.9.

arise in the general principles of contract law that fall within the ambit of Section 2's savings clause. As this Court has observed, however, contract law at its core, such as that incorporated by the savings clause, is not "diverse, nonuniform and confusing." *American Airlines*, 115 S. Ct. at 826 n.8 (quoting *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 519 (1992) (plurality opinion)). Thus, general principles of contract law typically do not impose contradictory and non-uniform requirement in the way that some states have imposed inconsistent methods of providing notice of arbitration. *See* Petr. Br. at 26 n.17, 28 n.20.[18]

By incorporating state law only "if that law arose to govern issues concerning the validity, revocability and enforceability of contracts generally," *Perry*, 482 U.S. at 493 n.9; *see Terminix*, 115 S. Ct. at 843, the savings clause of Section 2 serves as an important filter for state laws that discriminate against arbitration. For it is unlikely that a state would be willing to skew its law applicable to contracts generally simply to invalidate or burden arbitration agreements. It was, therefore, entirely consistent for Congress, when it enacted the FAA, to have included the savings clause to preserve the vitality

[18] Respondents forget that although national businesses must deal with varying state laws, one of the tools they use for that purpose is to include choice-of-law clauses in their contracts. In this case, DAI was deprived of its choice of Connecticut law because the Montana Supreme Court elevated the arbitration-specific notice statute to the level of a fundamental public policy. The preemption analysis that respondents support, therefore, would make the legal climate more unpredictable for national businesses, because a state could apply its own particular arbitration notice statute regardless of the parties' intent to apply another state's law. The result in this case would vary depending on whether respondents had sued in Montana, Connecticut or Delaware (respondents' residence since before this lawsuit was brought), since the latter two states would certainly have had no reason to have rejected the parties' choice of law and applied Montana's notice requirements to invalidate the parties' agreement to arbitrate.

of state general contract law—which provides the basic infrastructure for agreements to arbitrate as well as other contracts [19]—while at the same time preempting state notice laws like Montana's that impose special requirements on arbitration agreements that are not imposed on other contract terms. *Terminix*, 115 S. Ct. at 843; *id.* at 843-44 (O'Connor, J., concurring). As a matter of federal law, therefore, Montana's courts must enforce the parties' agreement to arbitrate. *Id.* at 843; *Mitsubishi*, 473 U.S. at 628.

CONCLUSION

The judgment of the Supreme Court of Montana should be reversed.

Respectfully submitted,

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Dated: April 4, 1996

[19] *See First Options*, 115 S. Ct. at 1924; 2 *Federal Arbitration Law* § 10.6.2.1, at 10:27.

No. 95-559

IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,
Petitioners,

v.

PAUL CASAROTTO and PAMELA CASAROTTO,
Respondents.

On Writ of Certiorari to the Supreme Court of Montana

BRIEF AMICUS CURIAE FOR THE AMERICAN COUNCIL OF LIFE INSURANCE IN SUPPORT OF THE PETITIONERS

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QUESTION PRESENTED

Whether state laws that condition the enforceability of arbitration provisions upon standards not applicable to other kinds of contractual provisions are preempted by Section 2 of the Federal Arbitration Act.

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INTEREST OF THE AMICUS

The American Council of Life Insurance ("ACLI") is the largest life insurance trade association in the United States, representing the interests of more than 600 member life insurance companies. These companies currently underwrite 90.9 percent of the life insurance in force in legal reserve life insurance companies in the United States.

Ensuring that states are not permitted to disfavor arbitration agreements, in violation of the Federal Arbitration Act, is a matter of vital importance to ACLI's members. First, these companies employ approximately 250,000 insurance sales representatives who have registered with the National Association of Securities Dealers ("NASD") to sell securities and, in conjunction with that registration,

have agreed to arbitrate all disputes with their insurer-employers. Second, a growing number of ACLI's members now use binding arbitration clauses in certain group annuity contracts, group health policies, and individual life insurance policies. Because of its genuine interest in promoting enforcement of arbitration agreements, therefore, ACLI submits this brief in order to provide the Court with the views of the life insurance industry on the important question presented by this case.[1] ACLI has previously filed *amicus* briefs in this Court on issues pertaining to the interpretation and enforcement of the Federal Arbitration Act. *See Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834 (1995).

STATUTORY PROVISIONS INVOLVED

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2 (1994), provides:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Mont. Code Ann. § 27-5-114(4) (1995) provides:

> Notice that a contract is subject to arbitration pursuant to this chapter shall be typed in underlined capital letters on the first page of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration.

[1] Counsel for both the Petitioners and the Respondents have consented to the filing of this brief. Their consents are on file with the Clerk.

STATEMENT

1. Because Petitioners set the facts forth fully in their brief, ACLI only summarizes the facts here. On April 25, 1988, respondent Paul Casarotto ("Casarotto") entered into a franchise agreement with petitioner Doctor's Associates, Inc. ("DAI") to open a Subway Sandwich Shop in Montana. Appendix to Petition for Certiorari ("Pet. App."), at 12a-13a.[2] The franchise agreement included an arbitration provision that provided that "[a]ny controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration . . . ." Pet. App. 13a.

2. Casarotto subsequently filed suit against both DAI and Lombardi, as well as other defendants, in the Montana Eighth Judicial District Court, Cascade County ("the trial court"). In his amended complaint, he alleged that he had entered into the franchise agreement and opened his shop at a less desirable location in reliance upon false representations by DAI and Lombardi that he would have the exclusive right to open a shop at a more desirable location when that location became available. Pet. App. 13a; Petition for Certiorari ("Pet."), at 5. He also alleged that DAI and Lombardi had interfered with efforts to sell his store. Pet. 5. On the basis of these allegations, he asserted claims for breach of contract, various torts, and violation of the Montana Consumer Protection Act. Pet. App. 13a; Pet. 6.

DAI and Lombardi moved to dismiss or stay the lawsuit pending arbitration, pursuant to the arbitration provision in the franchise agreement. The trial court granted the motion to stay, holding that the franchise agreement

[2] Petitioner Nick Lombardi is DAI's development agent in Montana. Pet. App. 12a. Respondent Pamela Casarotto is Casarotto's wife. The opinions of the courts below treated both Casarottos alike, although in fact only Paul Casarotto is asserting claims against DAI and Lombardi. Petition for Certiorari ("Pet."), at 5 n.4.

concerned interstate commerce, that Casarotto's claims against DAI and Lombardi "ar[o]se out of and relate[d] to the franchise agreement," and that DAI had properly demanded arbitration. Pet. App. 49a-50a.[a]

3. The Montana Supreme Court reversed the trial court's order. Its sole reason for doing so was that the franchise agreement did not comply with Mont. Code Ann. § 27-5-114(4), which provides that arbitration provisions are unenforceable unless the contracts containing them contain "[n]otice that [the] contract is subject to arbitration . . . typed in underlined capital letters on the first page of the contract . . . ." Pet. App. 27a.

4. DAI and Lombardi appealed the Montana Supreme Court's decision to this Court, which vacated the judgment and remanded for further consideration in light of *Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834 (1995). *See Doctor's Associates, Inc. v. Casarotto*, 115 S. Ct. 2552 (1995).

5. Notwithstanding the order to reconsider its earlier decision in light of *Terminix*, the Montana Supreme Court summarily reaffirmed and reinstated its original decision in the case, stating that "we can find nothing in the [*Terminix*] decision which relates to the issues presented to the Court in this case." Pet. App. 6a-7a.

SUMMARY OF ARGUMENT

I. Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2 ("Section 2"), provides that written agreements to arbitrate, when contained in contracts evidencing interstate commerce, must be enforced unless they are invalid on the basis of state law principles (such as duress) that are generally applicable to all contracts. Therefore, if a state conditions the enforcement of arbitration agreements

[a] These findings were not disturbed on appeal. *See* Pet. App. 6a (Montana Supreme Court assumed that there was a sufficient nexus with interstate commerce and that the Federal Arbitration Act was applicable).

upon compliance with requirements that the state does not obligate other kinds of agreements to meet, the additional requirements conflict with Section 2. The Montana notice statute at issue in this case makes arbitration provisions unenforceable unless they satisfy requirements that Montana law does not require other kinds of contractual provisions to meet. Consequently, the Montana notice statute conflicts with Section 2 and is preempted by it.

II. If states like Montana were permitted to impose special restrictions upon the enforceability of arbitration agreements, then, because the nature of such restrictions varies from state to state, life insurance companies could not enforce arbitration provisions in their policies unless they tailored those policies to conform to the requirements of individual states. Doing so would raise the cost of insurance. Moreover, because of the rather amorphous standards used in choice-of-law analysis, it is often difficult to predict which state's law might be applied to a particular policy. Consequently, in order to ensure that arbitration provisions in their policies will be enforced, life insurance companies would have to create policies that complied with the differing requirements of multiple states. To do so would be cumbersome at best and, in some cases, impossible.

ARGUMENT

I. MONTANA CODE ANN. § 27-5-114(4), WHICH CONDITIONS THE ENFORCEABILITY OF ARBITRATION PROVISIONS UPON STANDARDS THAT OTHER KINDS OF CONTRACTUAL PROVISIONS NEED NOT MEET, IS CONSEQUENTLY PREEMPTED BY SECTION 2 OF THE FEDERAL ARBITRATION ACT

A. Section 2 Of The Federal Arbitration Act Prevents States From Conditioning The Enforceability Of Arbitration Provisions Upon Standards That Other Kinds Of Contractual Provisions Need Not Meet

Section 2 provides that written agreements to arbitrate, when contained in a contract "evidencing a transaction involving [interstate] commerce," are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of *any* contract." 9 U.S.C. § 2 (emphasis added).[4] The Court has repeatedly held that Congress' intent in enacting this last phrase was to place arbitration agreements "upon the same footing as other contracts." *Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834, 838 (1995); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24, 33 (1991); *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 474, 478 (1989); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 225-226 (1987); *Dean Witter Reynolds v. Byrd*, 470 U.S. 213, 219 (1985); *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511 (1974); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 n.12 (1967) ("As the 'saving clause' in § 2 indicates, the purpose of Congress in 1925 was to make arbitration agreements as enforceable as other contracts . . . ."). Thus, state law may be applied to invalidate an arbitration provision only

[4] The same is true of separate agreements to arbitrate. *See* 9 U.S.C. § 2.

if the law "arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987).

It follows that if a state attempts to place arbitration provisions upon an unequal "footing" by requiring them to meet criteria that other kinds of contractual provisions need not meet, the additional requirements conflict with Section 2. *See Southland Corp.*, 465 U.S. at 16 n.11 (holding that a California statute that made arbitration agreements, but not other kinds of agreements, unenforceable was preempted by Section 2); *Perry*, 482 U.S. at 492 n.9 (finding that Section 2 preempted another California statute because "a state-law principle [of enforceability] that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with . . . § 2"). As this Court recently held in *Terminix:*

> What States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. The [Federal Arbitration] Act makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal "footing," directly contrary to the Act's language and Congress' intent.

115 S. Ct. at 843.

B. Mont. Code Ann. § 27-5-114(4) Conditions The Enforceability Of Arbitration Provisions Upon Standards That Other Kinds Of Contractual Provisions Need Not Meet, And Is Therefore Preempted By Section 2 Of The Federal Arbitration Act

Mont. Code Ann. § 27-5-114(4) ("the Montana notice statute") makes arbitration clauses unenforceable unless the contracts in which they appear contain a notice, "typed in underlined capital letters on the first page of the contract," that the contract is subject to arbitration.[5]

[5] Although the statute states that failure to comply with this requirement means that the contract "may" not be subject to arbi-

However, Montana law does not make the enforcement of other contractual provisions contingent upon the existence of such a notice. Consequently, the Montana notice statute does exactly what Section 2 forbids and is accordingly preempted as to all arbitration provisions that Congress has the power to regulate under Section 2.

In *Louisiana Public Service Commission v. FCC*, 476 U.S. 355, 369 (1986), the Court held that "[t]he critical question in any pre-emption analysis is always whether Congress intended that federal regulation supersede state law."[6] As discussed above in Part I.A. of the Argument, Congress clearly did intend Section 2 to supersede all state laws that create special obstacles to the enforcement of arbitration provisions. *See Perry*, 482 U.S. at 489 ("Section 2 . . . embodies a clear federal policy of requiring arbitration unless the agreement to arbitrate is not part of a contract evidencing interstate commerce or is revocable 'upon such grounds as exist at law or in equity for the revocation of any contract' ").

The Montana Supreme Court held that Section 2 does not preempt the Montana notice statute because the Montana statute "would not undermine the goals and policies of the FAA . . . ." Pet. App. 4a, 27a. But obviously the Montana notice statute *does* undermine what this Court has identified as the "basic purpose" of the Federal Arbitration Act: "to put arbitration provisions on 'the same footing' as a contract's other terms." *Terminix*, 115 S. Ct. at 840 (quoting *Scherk*, 417 U.S. at 511). The Montana Supreme Court's analysis, and its resulting conclusion that the Montana notice statute is not preempted, simply ignores (or at best misreads) both the plain language of Section 2 and the prior decisions of this Court.

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tration, the Montana Supreme Court has construed the statute to mean that the contract *shall* not be subject to arbitration. *See* Pet. App. 27a ("Because the agreement of the parties in this case did not comply with Montana's statutory notice requirement, it is not subject to arbitration, according to the law of Montana").

[6] Citing *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947).

II. PERMITTING STATES TO IMPOSE SPECIAL OBSTACLES TO THE ENFORCEMENT OF ARBITRATION AGREEMENTS WOULD INCREASE THE COST OF INSURANCE AND FORCE INSURERS TO COMPLY WITH REQUIREMENTS THAT NO SINGLE STATE WOULD HAVE IMPOSED

If states like Montana were allowed to flout Section 2 by placing special restrictions on the enforceability of arbitration agreements, life insurance companies could not enforce arbitration provisions in their policies unless they customized those policies to conform with the requirements of individual states, thus raising the cost of insurance. Moreover, because it is often difficult to predict which state's law might be applied to a particular policy, the only way for life insurance companies to guarantee that arbitration provisions in their policies will be enforced would be to create policies that complied with the special arbitration requirements of multiple states. However, it frequently would be difficult, if not impossible, to create such policies.

One way in which ACLI's members keep down the costs of their policies is to use nationally standardized forms. If it were necessary, in order to enforce a policy's arbitration provisions, that the policy be customized to comply with the special arbitration requirements of each state, such customizing would raise the costs of providing insurance and ultimately result in increased costs for policyholders. "[I]n insurance, as in other areas, customization invariably costs more than standardization." R. Keeton & A. Widiss, *Insurance Law* § 2.8, at 119 (1988).

Moreover, it is not always possible to predict which state's law will be applied when determining the enforceability of a particular policy's arbitration provisions. For example, even when a contract expressly specifies which state's law is to govern its enforcement, Montana will not apply that law if to do so would "violate[] Montana's public policy or [would be] against good morals." Pet. App. 17a (quoting *Youngblood v. American States Ins.*

Co., 866 P.2d 203, 205 (Mont. 1993)). Other states will also disregard the parties' choice of law on the basis of such considerations.[7] Obviously, it is difficult to predict when amorphous concepts like "public policy" or "good morals" might be used to invalidate the parties' choice of law.

Thus, if states were allowed to impose special restrictions on the enforcement of arbitration provisions, the only way to guarantee the enforcement of those provisions would be to issue policies that met the special arbitration requirements of all the states whose law might be applied. That could involve meeting the requirements of many states, because policyholders often move to another state after purchasing life insurance policies, it is obviously difficult to predict where they might move, and a court might apply the law of the new state in determining whether a policy's arbitration provision was enforceable. *See* Restatement (Second) of Conflict of Laws § 192 cmt. d (1988) (if the policyholder changes the state of his domicile after applying for a life insurance policy, a court might, in some cases, apply the law of the new state to issues arising under the policy). As a result, insurers would be required to contend with a cumbersome set of require-

[7] The Restatement (Second) of Conflict of Laws, which is followed by many states, provides that courts may refuse to enforce the parties' choice of law if, among other things, applying the law of the chosen state "would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which . . . would be the state of the applicable law in the absence of an effective choice of law by the parties." Restatement (Second) of Conflicts of Law § 187(2)(b) (1988). *See, e.g., Cherry, Bekaert & Holland v. Brown*, 582 So.2d 502, 507-508 (Ala. 1991) (refusing to enforce parties' choice of law); *National Glass, Inc. v. J.C. Penney Properties, Inc.*, 650 A.2d 246, 248-251 (Md. 1994) (same); *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 677-681 (Tex. 1990) (refusing to enforce parties' choice of law, but noting that the Restatement "offers little guidance" in determining what constitutes the "fundamental" policy of a state), *cert. denied*, 498 U.S. 1048 (1991).

ments, in the aggregate, that no individual state would have imposed. Furthermore, because those requirements often differ, and may even be inconsistent with each other, it would frequently be difficult, if not impossible, to comply with all of the potentially applicable requirements.[8]

CONCLUSION

For all of the foregoing reasons, the judgment below should be reversed.

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[8] An example of how states' requirements may differ is the variation in notice requirements for arbitration provisions. Montana and South Carolina require special notice of such provisions to be placed on the first page of contracts containing such provisions, while Missouri requires such notice to be placed adjacent to the signature block. S.C. Code Ann. § 15-48-10(a) (Law Co-op. Supp. 1995); Mo. Ann. Rev. Stat. § 435.460 (Vernon 1992). In addition, Rhode Island requires that arbitration provisions in insurance contracts must be placed immediately above the parties' signatures, whereas Iowa requires (in the case of tort claims) that the agreement to arbitrate must be in a separate writing executed by the parties. R.I. Gen. Laws § 10-3-2 (Supp. 1995); Iowa Code Ann. § 679A.1(2)(c) (West 1987). In order to comply with all of these statutes, a contract would have to contain special notices of arbitration both at the beginning and the end of the contract, and would have to contain arbitration agreements both in the body of the contract and in a separate writing. Compliance with these varying requirements would be cumbersome and inefficient, to say the least, and would involve surmounting a set of obstacles that none of these states would individually have imposed.

No. 95-559

In The

Supreme Court of the United States

October Term, 1995

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,

Petitioners,

vs.

PAUL CASAROTTO and PAMELA CASAROTTO,

Respondents.

On Writ of Certiorari to the Supreme Court of Montana

BRIEF OF AMICUS CURIAE KAISER FOUNDATION HEALTH PLAN, INC. IN SUPPORT OF PETITIONERS

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PARTIES' CONSENT FOR FILING THIS BRIEF AS AMICUS CURIAE

Kaiser Foundation Health Plan, Inc. ("Kaiser") submits this brief in support of petitioners Doctor's Associates, Inc. and Nick Lombardi. Both petitioners and respondents have consented to the filing of this brief pursuant to Rule 37 (3)(a).

I. AMICUS' INTEREST AND PERSPECTIVE

Kaiser's interest in this case is twofold. First, the arbitration provision in Kaiser's numerous contracts with employers, union welfare funds, and individuals is being challenged pursuant to a recently enacted California statute that requires a specialized arbitration notice similar to that imposed by the Montana statute in this case. Second, Kaiser's contracts contain choice of California law clauses that allegedly remove the protection of the Federal Arbitration Act ("FAA") based on erroneous interpretations of this Court's decision in *Volt Info. Sciences, Inc. v. Board of Trustees*, 489 U.S. 468 (1989).

Kaiser, a non-profit corporation, and its affiliates operate health maintenance organizations ("HMOs") in California and other parts of the United States. These HMOs arrange for health care services to millions of people under medical and hospital service agreements entered into with government agencies, private employers, union-management welfare funds, and individual subscribers. The basic terms of these service agreements are standard provisions that are subject to review and approval by state licensing agencies and the U.S. Department of Health and Human Services. Kaiser is regulated by the latter agency because Kaiser's HMOs are federally qualified under the federal Health Maintenance Organization Act of 1973, 42 U.S.C. § 300e, *et seq.*

The service agreements of the Kaiser HMOs in California and in several other regions of the United States include standard arbitration provisions. Kaiser's use of arbitration began in California more than twenty years ago. Kaiser's California arbitration provision, which applies to more than 4 million members, encompasses medical malpractice claims and other claims that arise from or are incident to the service agreements. The arbitration provision is governed by the FAA because the service agreements evidence transactions involving interstate commerce within the meaning of 9 U.S.C. §§ 1 and 2.

Kaiser's service agreements have for many years included two choice of law clauses that incorporate California law. The first clause ("the general clause"), which is one of several clauses under the heading "Miscellaneous Provisions," states:

> **I. Controlling Law.** This Agreement shall be governed in accord with the laws of the State of California.

The second clause ("the arbitration conduct clause"), which is found in the arbitration provision, provides:

> **E. General Provisions**. . . .
>
> * * *
>
> With respect to any matter not herein expressly provided for, arbitration shall be governed by the California Code of Civil Procedure provisions relating to arbitration that are in effect at the time the statute is applied.

In agreeing to these clauses, Kaiser never expected, much

less intended, that they would deprive Kaiser or the other contracting parties of the basic protection afforded by the pro-arbitration policies of the FAA. The purpose of the general clause has always been to have a predictable body of substantive law that would guide the parties in discerning their rights and obligations under the various provisions of the service agreements that pertain to the nature and scope of the health care services covered by the agreements, members' eligibility for this coverage, and the monetary consideration that is paid in exchange for this health care coverage.

The intended purpose of the arbitration conduct clause has been to adopt the body of procedural rules set forth in the California Arbitration Act, Calif. Code of Civ. Pro. § 1280, *et seq.*, which address a number of matters not specifically covered by the terms of the arbitration provision. These matters include: the appointment of a neutral arbitrator by the court if the parties fail to agree on a neutral (§ 1281.6); disclosures of potential conflicts of interest by proposed neutral arbitrators (§ 1281.9); the arbitrability of requests for temporary restraining orders and preliminary injunctions (§ 1281.8); the coordination of arbitrations with overlapping litigation involving parties who are not bound by the arbitration agreement (§ 1281.2(c)); the powers of the neutral arbitrator with respect to the scheduling of the hearing, issuance of subpoenas, and the admission of evidence (§§ 1281.2 & 1282.6); and the right to conduct discovery (§§ 1283.05 & 1283.1).

Since this Court's decision in *Volt, supra,* attorneys for member/claimants who contest the scope or enforceability of Kaiser's arbitration provision have begun to argue that the foregoing choice of law clauses render the FAA inapplicable. Although Kaiser maintains that the clauses are not intended to exclude the basic policies of the FAA, the dispute has so far proven to be academic because California law has generally

embraced the FAA's policies. However, the issue may soon cease to be academic in light of the California Legislature's recent enactment of section 1363.1, Calif. Health & Safety Code.

Section 1363.1, which became effective on January 1, 1995, requires that Kaiser and other California HMOs issue specified written notices of arbitration provisions in their service agreements. A prescribed notice must now appear immediately above the signature line of every service agreement, whether it be with an employer or an individual subscriber, § 1363.1. A similar notice must be given above the signature line of every enrollment form signed by individual subscribers when they enroll themselves and family members under a service agreement. *Id.*

While Kaiser has endeavored to comply with this new legislation, it is inevitable that the required notices will not be given in many instances due to circumstances beyond Kaiser's control. In the context of group plans, the enrollment forms are administered by employers or union welfare funds. Some of these organizations insist on using their own "standard" enrollment forms that do not comply with the new statute. Furthermore, many employers and union welfare funds that have contracted with Kaiser for years may mistakenly use old editions of Kaiser's own enrollment form rather than the new forms that contain the prescribed notice.

Because of the implications of § 1363.1, this case will directly affect Kaiser's reliance on arbitration as a means to achieve economical but fair resolutions of disputes with its members. For the reasons explained below, Kaiser hopes that this Court will unequivocally confirm that the FAA preempts any state law that imposes discriminatory notice burdens on the formation of valid arbitration agreements. In addition, because Kaiser prefers to continue to incorporate California law for the

purposes stated above, Kaiser urges the Court to dispel the notion that *Volt* removes the protection of the FAA whenever a contract includes a clause that incorporates state law.

II. INTRODUCTION

There are really two facets to this case. First, the Court now has a concrete opportunity to amplify the principle that the formation of arbitration agreements within the FAA's sphere must be judged on the basis of the same standards that apply to other categories of legally favored contracts.[1] To date, the Court has only alluded to this principle in footnote 9 of its opinion in *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987) and its general characterization of the FAA as a Congressional mandate that the courts place arbitration agreements "upon the same footing as other contracts." *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511 (1974).

The policy is straightforward: a state may not impose rules that discriminate against the enforcement of arbitration agreements. Congress favors arbitration agreements because they serve both the interests of the parties and the public. The FAA therefore enjoins courts to enforce these agreements "save upon such grounds as exist at law or in equity for the revocation of *any contract*." 9 U.S.C. § 2 (Emphasis added). The underscored words can only mean that the legal conditions that govern the creation of a valid arbitration agreement cannot be more onerous than those that govern other contracts that are favored by public policy.

---

1. The parity of treatment mandated by the FAA is not judged by reference to the class of "suspect" contracts for which a state has established special disclosure requirements to protect against overreaching. Rather, arbitration agreements are to be enforced on the same terms as ordinary contracts that enjoy a comparable favored status. *Saturn Distribution Corp. v. Williams*, 905 F.2d 719, 725 (4th Cir.), *cert. denied*, 498 U.S. 983 (1990).

This basic non-discrimination policy does not impede the traditional power of a state to regulate contracts to ensure that parties with inferior bargaining power are adequately informed of what they are agreeing to. Indeed, the FAA does not even prevent a state from banning all standard form contracts if it wished to do so. The Act simply prohibits states from making an arbitration provision run a special gauntlet that does not apply to other provisions in similar contracts.

The second challenge posed by this case is the need for clarification of the holding in *Volt Info. Sciences, Inc. v. Board of Trustees*, 489 U.S. 468 (1989). *Volt* has led to growing confusion regarding the impact of choice of law clauses on the core policies of the FAA. While some courts have been circumspect in their interpretation of *Volt*, other courts have viewed the decision as a license to ignore the FAA whenever a contract contains a clause that incorporates the law of a state jurisdiction. As a result, these choice of law provisions have become loopholes by which state laws are permitted to eradicate arbitration agreements under the guise of honoring the parties' intentions.

As noted by petitioners' brief, a growing number of states have enacted statutes, similar to the Montana statute now before the Court, that impose special disclosure requirements or other conditions on the formation of arbitration provisions. The FAA is the only legal shield that protects arbitration agreements from these discriminatory statutes. Unfortunately, this protection is being questioned at every turn because many arbitration agreements are coupled with common choice of law provisions that incorporate the law of the states that have legislated against arbitration. It is therefore imperative that this Court clarify *Volt* lest the benefits of arbitration become lost in a sea of litigation over whether choice of law clauses remove a contract entirely from the FAA's protective sphere.

The franchise contract in this case, of course, does not contain a choice of law clause that incorporated Montana law. However, the Montana Supreme Court based its decision entirely on *Volt*, and this Court will therefore be required to explain *Volt's* holding and the implications of this troublesome precedent. Kaiser submits that there is a right way and a wrong way to describe how *Volt* fits into the framework of federal arbitration law.

The wrong way is to distinguish *Volt* merely on the ground that the contract here did not incorporate Montana law. This approach is fraught with danger because it will be widely construed as a signal that the non-discrimination policy of the FAA can be easily overridden by a choice of law clause. The federal policy would prevail in this case but only by becoming extinct in numerous other cases involving contracts that select the law of a state that enacts a discriminatory notice statute.

Kaiser urges the Court to seize this opportunity to clarify that *Volt* stands for the proposition that a state court has wide latitude in determining whether a choice of law clause was intended to adopt state procedural rules that are designed to aid the practical implementation of arbitration agreements. The Court should also endorse the converse of this principle: if a state law would prevent the formation of a valid arbitration agreement, there must be very compelling evidence to overcome the presumption that the contracting parties did not intend to select any rule of law that would nullify their agreement. This presumption applies because the interpretation of a choice of law clause, insofar as it affects the parties' arbitration agreement, is ultimately governed by the FAA's standard that resolves all doubts in favor of arbitration.

III. *VOLT'S* CONFUSING LEGACY

The result reached in *Volt* is difficult to criticize. A California court construed a general choice of law clause as incorporating the procedural rules of the California Arbitration Act, a statute that is animated by the same pro-arbitration policy as evinced by the FAA. *See Madden v. Kaiser Foundation Hospitals*, 17 Cal. 3d 699, 706-07, 131 Cal. Rptr. 882 (1976).

The California rules did not invalidate the parties' arbitration agreement. They simply supplied a procedural mechanism for resolving the practical problem of how to coordinate an arbitration with an overlapping lawsuit involving parties who are not subject to arbitration. Thus, the majority in *Volt* correctly observed that the state court's interpretation of the choice of law clause was fully consistent with the core policies of the FAA.

A very different problem arises when a choice of law clause is deemed to incorporate a state law that nullifies the very arbitration agreement that the parties made, thereby jettisoning the FAA entirely. A growing number of courts have reached this conclusion on the mistaken belief that it is condoned, if not compelled, by *Volt*.

In *Rhodes v. Consumers' Buyline, Inc.*, 868 F. Supp. 368, 372-74 (D. Mass. 1993) and *Armco Steel Co., L.P. v. CSX Corp.*, 790 F. Supp. 311, 318-19 (D.D.C. 1991), the district courts concluded that defenses based on the alleged illegality of an entire commercial contract containing an arbitration provision were not arbitrable based on state rules of arbitrability. These rules, which reserve such issues for the courts, are directly contrary to this Court's holding in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 402-04 (1967), which requires

that a revocability defense directed at an entire contract, and not just the arbitration provision thereof, be referred to arbitration.

The *Rhodes* and *Armco* courts discarded the FAA by a mechanical syllogism: (a) the contract contains a choice of state law clause as in *Volt;* (b) ergo, the parties must have agreed to abandon the FAA and its liberal policy of arbitrability.

The decision of the Texas Court of Appeals in *American Physicians Service Group v. Port Lavaca Clinic Associates*, 843 S.W. 2d 675 (Tex. App. 1992) is another illustration of how *Volt* has been transformed into an unwitting device for evading the FAA. The court held that an arbitration provision was void because it was not specially highlighted as required by a Texas statute that imposed this technical requirement only on arbitration agreements. *Id.* at 677-78. Paying no heed to the core policies of the FAA, the court reasoned that the parties chose this discriminatory rule over the FAA because of a choice of law clause that stated:

> [A]ll controversies . . . shall be determined, to the extent consistent with federal and state law, by arbitration, to be held . . . pursuant to the arbitration laws of the State of Texas. . . .

Id. at 676. *Volt* was the cited authority for this "consensual" destruction of the arbitration agreement. *Accord, Albright v. Edward D. Jones & Co.*, 571 N.E. 2d 1329 (Ind. App. 1991), *cert. denied*, 506 U.S. 818 (1992).

Perhaps the most extreme interpretation of *Volt* as an exit from the FAA is *Yates v. Doctor's Associates, Inc.*, 193 Ill. App. 3d 431, 549 N.E. 2d 1010 (Ill. App. 1990). The court held that a franchisor had waived its right to arbitration by affirmatively seeking judicial relief on the merits in the state courts. Although

this conclusion could easily have been grounded on FAA precedents[2], the court elected to rely on Illinois law because it found that the franchisor had impliedly consented thereto by basing its motion to compel arbitration on the Illinois Uniform Arbitration Act. This implied abandonment of the FAA was predicated on the court's belief that *Volt* applied "with equal force" to the facts before it. *Id.* at 1016.

Yates is disturbing in that it demonstrates that *Volt* can be construed as calling for a forfeiture of FAA protection if the proponent of arbitration simply relies on a state arbitration statute as the procedural vehicle for compelling compliance with the arbitration agreement. This interpretation is irreconcilable with *Southland Corporation v. Keating*, 465 U.S. 1, 10-16 (1984) in which the Court held that the core policies of the FAA are fully applicable to proceedings to enforce arbitration rights in state court.

Not all courts have accepted the simplistic view that *Volt* allows courts to turn a deaf ear to the FAA whenever a contract contains a choice of state law clause. A number of courts have refused to construe ambiguous choice of law clauses as evidencing an intent to opt out of the FAA, especially when the allegedly "chosen" state law is inimical to arbitration.[3] However, as shown by the foregoing, there is mounting evidence

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2. *E.g., Zwitserse Maatschappij v. ABN Int'l Capital Markets Corp.*, 996 F.2d 1478, 1480 (2nd Cir. 1993) (waiver by filing action to obtain discovery not available in arbitration).

3. *E.g., Todd Shipyards Corp. v. Cunard Line*, 943 F.2d 1056, 1061-62 (9th Cir. 1991); *Ackerberg v. Johnson*, 892 F.2d 1328, 1333-34 (8th Cir. 1989); *Seymour v. C[illegible]'s Coffee*, 732 F. Supp. 988, 992-95 (D. Minn. 1990); *Merrill Lynch, [illegible] et al. v. Shaddock*, 822 F. Supp. 125, 133-37 (S.D.N.Y. 1993); *Osteen v. T.E. Cuttino Constr. Co.*, 434 S.E. 2d 281, 283-84 (S.C. 1993); *Dowd v. First Omaha Securities Corp.*, 495 N.W. 2d 36, 41 (Neb. 1993).

that, contrary to the Court's intent, *Volt* is often used to turn contract interpretation into a means for reviving "the ancient suspicion of arbitration." *Securities Industry Ass'n v. Connolly*, 883 F.2d 1114, 1119 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990).

IV. THE INTERPRETATION OF CHOICE OF LAW PROVISIONS BY BOTH FEDERAL AND STATE JUDGES IS SUBJECT TO THE FAA'S CORE POLICIES

Because the FAA does not compel parties to enter into arbitration agreements, one cannot rule out the possibility that the parties to an arbitration agreement might agree to remove the agreement entirely from the FAA's protection. There are two key issues, however, that beg clarification. Is the interpretation of this intent a matter of federal law? If so, what is the federal rule of interpretation?

Regarding the first issue, the Court has clearly indicated that the pro-arbitration policy of the FAA must be honored when a federal court construes the meaning of a choice of law clause in proceedings to compel arbitration or to vacate arbitral awards brought in federal court under the FAA. In *Mastrobuono v. Shearson Lehman Hutton, Inc.*, __ U.S. __, 115 S. Ct. 1212 (1995), the Court rejected the argument that a general choice of New York law clause necessarily meant that the parties agreed that arbitrators could not award punitive damages. The Court resolved the obvious ambiguity of the choice of law clause in favor of allowing punitive damages because there was evidence that the arbitration provision was intended to confer full remedial authority on the arbitrator. In doing so, the Court relied primarily on the core policy of the FAA that requires that all doubts be resolved in favor of arbitration. *Id.* at 1218 & n.8.

Although in *Mastrobuono* the Court examined the parties'

intent as a matter of federal law, a footnote to the majority opinion suggests that in *Volt* the Court was constrained to accept the state court's interpretation of the choice of law clause because " 'the interpretation of private contracts is ordinarily a question of state law, which this Court does not sit to review.' " *Id.* at 1217 n.4 (quoting from *Volt*, 489 U.S. at 474.) Insofar as this comment means that a state court may construe the parties' intent without regard for the FAA, it is quite incorrect.

The action in *Mastrobuono* was based on "a variety of state and federal law theories." *Id.* at 1214. Normally, a federal court decides a pendent state law claim based on the applicable state law. Yet, this Court resolved the arbitrability issue as to both the federal and pendent state law claims as a matter of federal law. It logically follows that had the same arbitrability issue been raised in state court, the state court would likewise be subject to the overriding federal standard of interpretation because the agreement was within the purview of the FAA.

That the FAA creates an overarching federal standard is also borne out by *Prima Paint, supra.* There, the Court held that in a pure diversity case, the FAA policy of arbitrability applies as a matter of federal law. 388 U.S. at 402-05. Later, in *Southland Corporation v. Keating, supra,* the Court confirmed that the FAA remains paramount even with respect to issues of arbitrability that arise in state court proceedings. 465 U.S. at 10-16.

Thus, while the application of the premise of Justice Brennan's dissent in *Volt* may be debatable in a given case, the premise itself is indisputable: a state court's interpretation of a choice of law clause must comport with the core policies of the FAA. The *Volt* majority also embraced this premise since the majority emphasized that the state court's interpretation of the choice of law clause did not offend the FAA. 489 U.S. at 476. The Court has followed the same principle when reviewing other

state court decisions concerning private contracts that are subject to overriding federal standards. *E.g., Swarb v. Lennox,* 405 U.S. 191 (1972) (federal constitutional standard governs whether debtors agreed to confession of judgment procedure).

In some cases, like *Volt,* in which the state court rules in question reflect a pro-arbitration policy, there ordinarily is no need to upset a state court's interpretation of the purpose and scope of a choice of law clause. However, when the allegedly chosen state rule precludes or impairs the formation or enforceability of an arbitration provision, courts must construe the contract with a "healthy regard for the federal policy favoring arbitration." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.,* 473 U.S. 614, 626 (1985), *quoting Moses H. Cone Memorial Hospital v. Mercury Construction Corp.,* 460 U.S. 1, 24-25 (1983). This rule of interpretation proceeds from the presumption that the parties did not intend to incorporate a state law that nullifies or impairs their arbitration agreement. If "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration. . . .", *Moses H. Cone, supra,* 460 U.S. at 24-25, surely the same "all doubts" presumption must apply when a claim is made that the parties to an arbitration agreement intended to adopt rules that challenge or defeat the very existence or validity of their agreement.

By clearly declaring that choice of law issues are governed by the "all doubts" presumption, this Court will not only end the confusion surrounding *Volt,* but it will also encourage private parties to continue to rely on state arbitration rules to implement their arbitration agreements. Many states have arbitration statutes that are not only favorable to arbitration but reflect refinements and innovations that address issues which Congress never contemplated when it enacted the FAA in 1925. *See Volt,* 489 U.S. at 476 n.5. Furthermore, because the FAA does not prescribe rules concerning the conduct of an arbitration,

Southland Corporation, supra, 465 U.S. at 11 n.6, Congress undoubtedly expected that private parties would often look to state law for guidance concerning the right to conduct discovery, the scheduling of arbitration hearings, the admissibility of evidence, and similar matters. *See* Part I above.

On the other hand, if the Court does not disclaim the unbridled interpretations of *Volt,* business organizations and other parties will be forced to rewrite their contracts to omit any sentence that might be construed as an incorporation of all state laws relating to arbitration. Indeed, if decisions such as *Yates, supra,* are heeded, a party will not even dare to base an action to compel arbitration on the local jurisdiction's arbitration statute lest a citation to the statute be deemed an implied consent to the application of all state rules, including those that are aimed at defeating arbitration. Since most actions to compel arbitration must be brought in state court where the procedural provisions of the FAA probably do not apply[4], this risk avoidance strategy can only lead the parties and state court judges into a procedural void. Thus, by affirming that choice of law clauses, as they affect arbitration, are governed by a federal rule of interpretation, the Court will ensure both a "healthy regard" for federal policy and a healthy use of the many state laws that assist the practical implementation of arbitration agreements.

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4. The FAA does not constitute an independent basis for federal question jurisdiction, *e.g., Southland Corporation, supra,* 465 U.S. at 15 n. 9, and sections 3 and 4 of the FAA appear to apply only to proceedings in federal court, *Volt,* 489 U.S. at 477 n.6.

V. CONCLUSION

On the basis of the foregoing, Kaiser urges the Court to explain *Volt* in a manner that does not fuel the mistaken view that a choice of state law provision can be construed without obedience to the *federal* rule of interpretation under which reasonable doubts are resolved in favor of arbitration. In rejecting respondents' *Volt* argument, the Court should emphasize that this case has a critical fact that was missing in *Volt: viz.* a state law that is plainly antithetical to arbitration. Given the strong presumption that the parties to an arbitration agreement intend their agreement to be enforced and not torn asunder, respondents bore the heavy burden of proving that the parties intended to incorporate a state statute that nullifies their arbitration agreement. Because this burden was not met, the decision should be reversed.

Respectfully submitted,

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No. 95-559

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,

Petitioners,

v.

PAUL CASAROTTO and PAMELA CASAROTTO,

Respondents.

On Writ of Certiorari to the Supreme Court of Montana

BRIEF FOR THE INTERNATIONAL FRANCHISE ASSOCIATION AND THE SECURITIES INDUSTRY ASSOCIATION, AS AMICI CURIAE SUPPORTING PETITIONERS

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INTEREST OF THE AMICI CURIAE

The International Franchise Association ("IFA"), founded in 1960, is the oldest and largest trade association in the world representing the interests of franchising. IFA has more than 750 franchisor members and, since first inviting franchisees to join in 1993, has already attracted more than 27,000 franchisee members. IFA serves as a resource center for current and prospective franchisors and fran-

chisees, state and federal government agencies, and the public. IFA also represents the interests of franchising before legislatures, the courts, and the public. The Association has been instrumental in promoting balanced legislation to regulate franchising practices in the United States.

A franchise is a contractual relationship in which the franchisor, the owner of a business concept and associated trademarks or service marks, authorizes a franchisee to conduct a business that is identified by the franchisor's marks and uses the franchisor's format and operating system. The contractual relationship is defined by a franchise or license agreement, which sets forth the respective obligations of the franchisor and franchisee. To promote uniformity in their franchise networks, franchisors utilize standardized agreements. However, such "form" agreements are frequently subject to negotiation. An increasing number of franchising companies, in an effort to resolve disputes with their franchisees in the least costly, least disruptive and most expeditious manner possible, include in their franchise agreements an undertaking to resolve disputes by arbitration, binding on both the franchisor and the franchisee. Such agreements obligate the parties to arbitrate disputes, usually under the auspices of the American Arbitration Association or similar organization, and often in the home state of the franchisor. In the past year alone, almost 400 arbitrations involving franchise relationships were initiated with the American Arbitration Association.

The Securities Industry Association ("SIA") is a not-for-profit corporation formed under the laws of Delaware. SIA is the securities industry trade association representing the interests of more than 700 securities firms in

North America, which collectively account for 90% of securities firms' revenue in the United States.

The relationship between SIA members and their customers, particularly those who borrow money from member , or who trade in options, is sometimes governed by a written agreement which contains a clause requiring the arbitration of disputes. Most of these agreements also contain a choice-of-law provision. SIA has a deep concern that these agreements be enforced in accordance with the terms of the Federal Arbitration Act ("FAA"). SIA has been a successful plaintiff against the Commonwealth of Massachusetts and the State of Florida in cases to enforce arbitration clauses despite restrictive state laws or regulations. Consistent enforcement of arbitration agreements is important to both SIA members and their customers since inconsistent enforcement of the FAA will lead to uncertainty and confusion for both parties to the contract.

Historically, many state courts and state legislatures have looked with disfavor on arbitration, especially when it occurred as the result of a pre-dispute agreement to arbitrate. Whether this reluctance to honor agreements to arbitrate stemmed from the belief that arbitration did not afford the same procedural or substantive safeguards as litigation, or whether it grew out of the states' desire to preserve in-state forums for their citizens, the end result was that arbitration agreements were routinely disregarded. With the passage of the FAA and rigorous enforcement of arbitration agreements under the FAA, especially by federal courts, most state courts and legislatures grudgingly accepted arbitration as a legitimate means of resolving disputes. In the past several years, however, a backlash has occurred. A number of states, including Montana and most recently California, have enacted statutes that, under the guise of ensuring that arbitration

agreements are freely entered into, seriously undermine the enforceability of agreements to arbitrate, and courts have upheld the validity of these statutes despite the preemptive reach of the FAA. One of the most prevalent examples of such legislation is the Montana statute that is the subject of the Montana Supreme Court's two decisions below.[1] That statute requires that notice of the existence of an agreement to resolve disputes by arbitration be displayed on the first page of the contract in underlined, capital letters, a requirement that is applicable only to arbitration agreements, not to contracts generally. While federal courts have consistently struck down anti-arbitration statutes of this type on preemption grounds, a growing number of state courts, of which the Montana Supreme Court is but the latest example, have held otherwise, permitting states to single out arbitration agreements for unfavorable treatment.

Amici are vitally concerned about this case because permitting the most recent decision of the Montana Supreme Court to stand, particularly after this Court's summary vacatur and remand of the case for consideration in light of *Allied-Bruce Terminix Companies, Inc. v. Dobson*, 115 S. Ct. 834 (1995), will encourage other state courts and legislatures to undertake similar steps to undercut the enforceability of agreements to arbitrate and further thwart

[1] The Montana Supreme Court's most recent opinion in this case, dated August 31, 1995, together with the special concurrence and dissent, is printed as Appendix A to the Petition for a Writ of Certiorari filed with the Court in this case. The Montana Supreme Court's initial opinion in this case, dated December 15, 1994, together with the special concurrence and dissents, is printed as Appendix B to the Petition for a Writ of Certiorari. References to the lower court's opinions are designated "App. A" and "App. B," respectively, followed by a page reference.

the strong federal policy favoring arbitration. Legislatures will continue to enact statutes that impose burdensome conditions on the formation or performance of arbitration agreements. And courts will continue to invoke these statutes to overturn arbitration agreements either by disregarding parties' choice-of-law clauses or, what is worse, by applying these clauses ostensibly to honor the parties' "intention" to forgo arbitration in the face of an unambiguous agreement to arbitrate. As a result, franchisors and securities firms that include arbitration provisions in their form agreements will either be forced to tailor their agreements to the laws of 50 different states or forgo the many advantages inherent in the arbitration process. Even now, the inconsistent treatment of arbitration agreements caused by state notice provisions introduces great uncertainty into the enforcement of those agreements and spawns satellite litigation over the enforceability of the notice provisions that threatens to erase the benefits of economy and efficiency that arbitration was originally intended to produce.

Pursuant to Rule 37.3 of the Rules of this Court, IFA and SIA, respectfully submit this brief as *amici curiae* in support of petitioners. Because many IFA members, both franchisors and franchisees, and many securities firms, utilize arbitration as a means of resolving disputes, IFA and SIA have a substantial interest in the outcome of this case and are able to provide an additional and broader prospective on the issues presented. IFA and SIA believe this brief will assist the Court in analyzing and resolving these issues. The parties have consented to the filing of this brief, and their written consents have been filed with the Clerk of Court.

SUMMARY OF ARGUMENT

In the decision below, the Montana Supreme Court persists in underestimating the preemptive reach of Section 2 of the FAA by holding that Montana's notice requirement for arbitration agreements does not violate the Supremacy Clause. In doing so, the Montana Supreme Court continues to disregard two controlling decisions of this Court, *Southland Corp. v. Keating*, 465 U.S. 1 (1984), and *Perry v. Thomas*, 482 U.S. 483 (1987), both of which held that states may not restrict the enforceability of agreements to arbitrate except on "grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Since Montana's notice requirement is directed exclusively at arbitration provisions and not at any other contractual terms, it is preempted by the FAA. In addition to conflicting with *Southland* and *Perry*, the Montana Supreme Court's decision also runs directly contrary to the decisions of the three federal courts of appeals that have addressed the issue, all of which held that state arbitration notice requirements are preempted by the FAA. Instead of following these decisions, the court below in its initial opinion relied on two intermediate state courts in Indiana and Texas that upheld similar notice provisions. Reversal of the decision below is necessary to signal to state courts and legislatures that, for purposes of preemption under the FAA, burdening the enforceability of arbitration agreements with a notice provision is no different than declaring those agreements unenforceable *per se*.

By maintaining that Montana's notice provision does not undermine the goals and policies of the FAA because it ensures consensual arbitration, the Montana Supreme Court also continues to distort this Court's holding in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989). The decision in *Volt* was premised on the notion that the primary purpose of the FAA is to enforce privately negotiated agreements to arbitrate, even where those agreements allow for arbitration to be stayed pending the resolution of related litigation. Because the parties here chose the AAA's Commercial Arbitration Rules and Connecticut law, not Montana law, to govern their arbitration agreement, *Volt* requires that their choice be upheld and not, as the Montana Supreme Court reasoned, that another state's law be substituted that would invalidate the parties' agreement to arbitrate. In addition, although in *Volt* this Court observed that the FAA does not entirely preempt state arbitration laws, and in particular state laws governing the procedures under which arbitration is conducted, the Montana Supreme Court perverted this holding into a license to enforce a state arbitration law that went to the very substance of the right to arbitrate, prohibiting arbitration from occurring altogether. The Montana Supreme Court's conclusion that the FAA mandates the enforcement only of those arbitration agreements that are entered into "knowingly," which Montana's notice provision is purportedly designed to promote, flies in the face of the FAA's insistence that arbitration agreements be placed on the same footing as other agreements. Because of the purported solicitude for arbitration of the majority of the Montana Supreme Court, when in fact its decision and the statute it enforced are based on hostility to arbitration agreements, it is crucial that this Court reverse the Montana Supreme Court's most recent decision in this case to discourage similar attempts by state courts and legislatures to undermine the FAA on the pretext of furthering its goals and policies.

The Montana Supreme Court's decisions below are also premised on judicial and legislative hostility to arbitra-

tion, which has long been discredited by this Court in view of the many advantages that arbitration affords over traditional litigation. These advantages include speed, economy, adjudicative expertise and the capacity to preserve long-term relationships once the dispute is resolved. To enforce statutes like Montana's either would deprive the parties to a franchise relationship of these advantages altogether, or would seriously impede the use of arbitration in the franchise relationship by forcing franchisors to tailor their contract documents to meet the arbitration requirements of 50 different states. Moreover, the Montana Supreme Court's reasoning is based on unsupported and unfounded assumptions regarding the negotiability of arbitration agreements and the role of forum-selection clauses in those agreements.

ARGUMENT

I.

MONTANA'S STATUTORY NOTICE PROVISION FOR ARBITRATION IS PREEMPTED BY THE FEDERAL ARBITRATION ACT

In maintaining that the FAA does not preempt Montana's statute requiring that a contract containing an arbitration agreement include a conspicuous notice to that effect on the face of the contract, the Montana Supreme Court continues to disregard two of this Court's controlling precedents and a substantial number of lower federal court decisions that flatly refute the Montana Supreme Court's holding. In so doing, the Montana Supreme Court has severely restricted the preemptive reach of the FAA. Moreover, to justify its hostility to arbitration, the Montana Supreme Court persists in distorting this Court's holding in *Volt Information Sciences, Inc. v. Board of Trustees*

of Leland Stanford Junior University, 489 U.S. 468 (1989), into a license to disregard arbitration agreements on the pretext of honoring the parties' intentions.

A. The Montana Supreme Court's Decision Disregards Prior Decisions Of This Court And Other Lower Federal Courts

In the decision below, the Montana Supreme Court "reaffirm[ed] and reinstate[d]" its prior holding that the Montana notice provision is not preempted by Section 2 of the FAA because the notice requirement does not undermine the goals and policies of the FAA. App. A at 7a. In so doing, however, the Montana Supreme Court continues to disregard this Court's controlling decisions in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), and *Perry v. Thomas*, 482 U.S. 483 (1987). In holding that a provision of the California Franchise Investment Law requiring judicial consideration of claims brought under the statute was preempted by the FAA, this Court in *Southland* declared that state law may limit the enforceability of agreements to arbitrate *only* upon " 'grounds as exist at law or in equity for the revocation of *any* contract.' " 465 U.S. at 11 (quoting 9 U.S.C. § 2) (emphasis added). Likewise, in *Perry*, this Court struck down a provision of the California Labor Code, which precluded arbitration of wage collection claims, on the ground that the California law did not "[arise] to govern issues concerning the validity, revocability, and enforceability of contracts generally," but rather "[took] its meaning precisely from the fact that a contract to arbitrate is at issue." 482 U.S. at 492 n. 9.

The Montana statute at issue here is preempted by the FAA because it clearly "takes its meaning precisely from the fact that a contract to arbitrate is at issue." Montana does not require that any other contractual provision be

flagged with a conspicuous notice provision on the first page of the contract. Arbitration agreements alone are burdened with this requirement in Montana—burdened, in that the absence of such a notice renders the agreement to arbitrate unenforceable. Under this Court's decisions in *Southland* and *Perry*, therefore, the Montana statute is preempted by the FAA.

Indeed, in a recent pronouncement on the FAA, this Court reaffirmed that, under its holdings in *Southland* and *Perry*, the FAA preempts state laws that seek to invalidate arbitration agreements. *See Allied-Bruce Terminix Companies, Inc. v. Dobson*, 115 S. Ct. 834 (1995); *accord Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1215-16 (1995). In *Terminix*, this Court decisively rejected a request to overrule *Southland* and permit state courts to apply their own anti-arbitration laws regardless of whether interstate commerce was involved, holding that *Southland* was well-established law and that, consequently, Alabama could not apply its statute barring pre-dispute arbitration agreements to invalidate an arbitration provision. *Terminix*, 115 S. Ct. at 838-39. After observing that the "basic purpose of the Federal Arbitration Act is to overcome courts' refusal to enforce agreements to arbitrate" and to place those agreements " 'upon the same footing as other contracts,' " *id.* at 838 (quoting *Volt*, 489 U.S. at 474), Justice Breyer, writing for this Court, concluded that while "States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause 'upon such grounds as exist at law or in equity for the revocation of *any* contract'[,] . . . [w]hat States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause," *Terminix*, 115 S. Ct. at 843 (quoting 9 U.S.C. § 2) (emphasis in original).

Montana has done precisely what this Court and numerous other federal and state courts over the past decade have held that it cannot do: It has decided that contracts are fair enough to enforce all their basic terms, even absent a special notice designed to bring the existence of those terms to the parties' attention, but that arbitration agreements are not fair enough to enforce without such a notice. Since this Court in *Terminix* made clear that state laws that place arbitration agreements "on an unequal footing" by definition undermine the goals and policies of the FAA, *Terminix*, 115 S. Ct. at 843, the Montana Supreme Court's refusal on remand to apply the principles reaffirmed in *Terminix* requires reversal.

The Montana Supreme Court's holding also disregards the contrary decisions from the three federal courts of appeals that have addressed the issue, all of which have invalidated arbitration notice provisions similar to the Montana statute. *See, e.g., David L. Threlkeld & Co., Inc. v. Metallgesellschaft, Ltd. (London)*, 923 F.2d 245, 249-50 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991) (invalidating a Vermont statute that required agreements to arbitrate to be "prominently displayed" in contracts and signed by the parties); *Securities Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1120 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990) (invalidating a state regulation requiring full written disclosure of "the legal effect of the pre-dispute arbitration contract or clause"); *Webb v. R. Rowland & Co.*, 800 F.2d 803, 806-07 (8th Cir. 1986) (invalidating a requirement that contracts highlight the existence of arbitration clauses in 10-point capital letters); *Collins Radio Co. v. Ex-Cell-O Corp.*, 467 F.2d 995, 997-99 (8th Cir. 1972) (invalidating a requirement that arbitration agreements bear an attorney's acknowledgement that all parties have been advised of the agreement's effects). Instead, the Montana Supreme

Court has joined a growing number of state courts that have reinvigorated the former hostility to arbitration by concluding that arbitration notice provisions do not run afoul of the FAA. *See, e.g., American Physicians Service Group, Inc. v. Port Lavaca Clinic Assoc.*, 843 S.W.2d 675, 678 (Tex. Ct. App. 1992) (en banc), *writ of error denied* (Tex. Apr. 21, 1993); *Albright v. Edward D. Jones & Co.*, 571 N.E.2d 1329, 1332-33 (Ind. Ct. App. 1991), *cert. denied*, 113 S. Ct. 61 (1992). In addition, a number of states have similar laws that single out arbitration agreements for unfavorable treatment by regulating the placement and acknowledgment of arbitration agreements in certain types of contracts.[2] Courts in those states could well be encouraged by the Montana Supreme Court's decision below to uphold similar anti-arbitration statutes against preemption attacks. Thus, there is a compelling need for this Court to reverse the decision of the Montana Supreme Court in order to signal to state courts and legislatures that, for purposes of preemption under the FAA, statutory notice provisions for arbitration are no less hostile to arbitration than were the statutes at issue in *Southland* and *Perry*.

B. The Montana Supreme Court's Decision Distorts This Court's Reasoning In *Volt*

In sustaining the Montana statute against a preemption attack, the Montana Supreme Court persists in its distortion of this Court's reasoning in *Volt* in several respects. First, the decision below completely disregards the parties' arbitration agreement. As this Court observed in *Volt*, the primary purpose of the FAA is to enforce

[2] *See* Petition for a Writ of Certiorari, at 23 nn. 20 & 21 (citing statutes).

"privately negotiated arbitration agreements"; thus, parties to an arbitration agreement should be "at liberty to choose the terms under which they will arbitrate." 489 U.S. at 472. Here, the parties chose the AAA's Commercial Arbitration Rules and Connecticut law, not Montana law, to govern their arbitration agreement. Since neither Connecticut law nor the AAA's rules nor the FAA conditions the enforceability of an agreement to arbitrate on the existence of a notice provision, *Volt* cannot support the result reached by the Montana Supreme Court. On the contrary, the very notion of enforcing a notice provision *not* chosen by the parties to invalidate an arbitration provision *chosen* by the parties is completely antithetical to the teaching of *Volt* and strikes at the heart of the FAA's purpose—to ensure that private agreements to arbitrate are rigorously enforced according to their terms.

Second, the Montana Supreme Court's unduly narrow interpretation of the scope of federal preemption of state arbitration laws is impossible to square with *Volt*. Purportedly relying on *Volt*, the Montana Supreme Court in its initial opinion declared that Montana's notice requirement does not "undermine the goals and policies of the FAA" because Congress never intended to preempt the entire field of arbitration and because the FAA does not require parties to arbitrate when they have not agreed to do so. App. B at 26a. The Montana Supreme Court reaffirmed that holding in its most recent opinion, finding that *Terminix* had not modified the preemption language in *Volt* on which the Montana Supreme Court had relied in its earlier opinion. However, this Court's statement in *Volt* that the FAA does not entirely preempt state arbitration law was made in reference to a California *procedural* statute that merely had the effect of delaying an arbitration until after litigation of related claims had

occurred—and under circumstances where the parties had chosen that law to govern their arbitration. Thus, the California law affected only the timing of arbitration, and did not purport to prohibit arbitration altogether. Here, however, the Montana Supreme Court has interpreted *Volt* to permit a state to ban arbitration in its entirety, notwithstanding the existence of an arbitration agreement enforceable under the laws of the parties' own choosing. Even if the parties had chosen Montana law to govern their franchise agreement, the Montana Supreme Court's holding would still be indefensible, because choice-of-law clauses, like arbitration agreements generally, must be construed in light of the federal presumption that resolves all doubts in favor of arbitrability. *See Mastrobuono*, 115 S. Ct. at 1218 & n. 8.

Nor does the justification offered by the Montana Supreme Court for its holding—that the FAA mandates the enforcement only of those arbitration agreements that are "knowingly" entered into—survive scrutiny. Since the "knowing" requirement applies only to arbitration agreements and not to contracts generally in Montana, it is preempted under *Southland* and *Perry*. Although Montana could ban all standard form contracts in an effort to ensure that parties with inferior bargaining power "know" what they are agreeing to, it cannot impose this requirement only on arbitration agreements. Behind Montana's preoccupation with ensuring that arbitration agreements are "knowingly" entered into lies considerable legislative and judicial hostility toward arbitration. Because the Montana Supreme Court's purported solicitude for arbitration may encourage other state courts or legislatures to employ similar artifices to turn the FAA on its head, it is critical that this Court reverse decision below.

II.

THE MONTANA SUPREME COURT'S DECISION REPRESENTS UNSOUND PUBLIC POLICY

Arbitration notice provisions like Montana's not only run afoul of the Supremacy Clause and Section 2 of the FAA but also represent unsound public policy based on discredited judicial and legislative hostility to arbitration. Opponents of arbitration have long maintained that arbitration represents an inferior, and inadequate, form of justice compared with traditional litigation because (they say) it deprives parties of, among other things, substantive rights under state statutory and common law, the right to a jury trial, wide-ranging discovery procedures, a broad right of appeal, competent adjudicators and, in many cases, an in-state forum. Detractors of arbitration also question the consensual nature of pre-dispute arbitration agreements, pointing out that those agreements are often contained in non-negotiated form contracts between parties of unequal bargaining power. These anti-arbitration sentiments, barely concealed in the initial majority opinion of the Montana Supreme Court, came to the surface in the special concurring opinion of Justice Trieweiler filed with the initial majority opinion. App. B at 28a-32a. Although the Montana Supreme Court has since attempted to distance itself from those sentiments as the basis for its holding, especially in light of the language in *Terminix* "extolling the virtues of arbitration," App. A at 7a (citing *Terminix*, 115 S. Ct. at 843), its continuing animosity to arbitration is apparent when it attributes this Court's recognition of the benefits of arbitration to partisan "input" from the AAA. App. A at 7a. There is little question that the Montana Supreme Court's holding continues to be motivated by a distrust of arbitration and the benefits it affords.

This Court, however, has repeatedly dismissed as unfounded the various objections to arbitration noted above[3] and, in doing so, has acknowledged the many benefits of arbitration. These include speed, *see, e.g., Terminix*, 115 S. Ct. at 843; economy, *see, e.g., id.*; informality and adaptability of procedures; *see, e.g., Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 633 (1985); availability of expert adjudicators, *see, e.g., Mitsubishi*, 473 U.S. at 633; and ability to preserve the disputants' relationship after the matter is concluded, *see Terminix*, 115 S. Ct. at 843. Moreover, as this Court has observed, arbitration offers advantages to large and small businesses as well as to individuals, notwithstanding that it is often invoked under a form contract between parties having unequal bargaining power. *See Terminix*, 115 S. Ct. at 843; *Gilmer v. Interstate/Johnson Lane Corp.*, 111 S. Ct. 1647, 1655 (1991).

Permitting the decision below to stand, with its inherent bias against arbitration, will encourage other state courts and legislatures to seek various ways to impair the enforceability of arbitration agreements, with serious repercussions for all business relationships that rely on arbitration to effectively and economically resolve disputes, but particularly for the franchise industry. Arbitration enjoys widespread use in franchise relationships because it offers many advantages over traditional litigation to franchisors and franchisees. Arbitration is typically much less expensive than litigation because of the absence of, or limitations on, pleading requirements, motion practice, discovery and pretrial procedures. Since many disputes between franchisors and franchisees, such as claims for nonpayment of royalty fees, involve relatively small amounts of money, arbitration enables the parties to resolve these disputes economically without incurring legal expenses that might otherwise approximate the entire value of the claim. Moreover, the great majority of franchisors are relatively small companies and, like many franchisees, cannot afford the high cost associated with pursuing or defending claims in a judicial forum. For the same reasons, arbitration is also the prevailing method used to resolve disputes in retail securities brokerage relationships. Arbitration affords investors a cost-effective method to assert claims and resolve disputes with securities brokers.

[3] The various objections to arbitration which this Court has dismissed include: 1) its inability to further important social policies, *see Gilmer v. Interstate/Johnson Lane Corp.*, 111 S. Ct. 1647, 1653 (1991); 2) inherent bias of arbitrators, *see id.* at 1654; *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 634 (1985); 3) lack of discovery procedures, *see Gilmer*, 111 S. Ct. at 1654-55; 4) lack of meaningful judicial review, *see Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 232 (1987); incompetence of arbitrators, *see McMahon*, 482 U.S. at 232; 6) limitations on substantive rights or relief, *see Gilmer*, 111 S. Ct. at 1655; and 7) its use by parties of unequal bargaining power, *Gilmer*, 111 S. Ct. at 1655.

The elimination or reduction in scope of motion practice, discovery and pretrial procedures in arbitration also makes it generally much quicker than litigation. The relative speed with which arbitrations proceed from the initial filing of the arbitration demand to the issuance of an award and, if necessary, confirmation of the award by a court, not only will in most cases cost the parties less in attorneys' fees but also will enable them to resume their relationship more quickly, without the continuing disruptive influence of a pending lawsuit. This advantage of arbitration is particularly significant to franchisors and franchisees since the disputes between these parties that give rise to arbitration often will not signal the end of the franchise relationship.

For largely similar reasons, the informality and often less adversarial nature of arbitration are important because they enhance the prospect that a franchisor and its franchisee will be able to honor their contractual obligations while the arbitration is pending and put aside their differences once the arbitration has concluded, keeping their relationship intact. Franchise relationships are unique in today's business world because they typically run for a period of ten to twenty years. Since disputes are more likely to arise in a relationship of that length, arbitration offers a method for resolving those disputes while preserving the long-term nature of the relationship. Moreover, because arbitration is more flexible with regard to scheduling times and places of hearings, it tends to be less disruptive of the day-to-day operations of franchisors and franchisees alike, an important consideration in light of the fact that many franchisors and franchisees are small businesses with limited personnel. Finally, arbitration also offers the parties to a franchise relationship the option of having an individual experienced in franchising adjudicate their dispute. Because franchising is a unique form of business organization and is subject to a wide array of registration, disclosure and relationship laws, franchising expertise is often a sought-after qualification of arbitrators chosen to decide franchise disputes.

Moreover, there is nothing inherent in the arbitration process itself that favors franchisors over franchisees. Contrary to the anti-arbitration sentiments expressed in the initial special concurring opinion of Justice Trieweiler, App. B at 28a-32a, franchisees are often sophisticated, multi-unit operators who, on their own behalf or through counsel, negotiate the terms of their franchise agreements, including whether and under what circumstances arbitration of disputes will occur. Although arbitration agreements often provide for arbitration in the franchisor's home state, there are sound business reasons for a franchisor to consolidate disputes with its franchisees in a forum where it can resolve them as cost-effectively as possible. It is certainly no more burdensome for an individual franchisee to arbitrate once in the franchisor's home state than it is for a national franchisor to arbitrate many times in the home states of its franchisees. Indeed, in light of this Court's decision in *Carnival Cruise Lines, Inc. v. Shute*, 111 S. Ct. 1522 (1991), which upheld the enforceability of a non-negotiated choice-of-forum clause printed on the reverse side of a cruise line passenger ticket, forum selection clauses in the franchise relationship—a business relationship—are beyond reproach.

Enforcement of arbitration agreements in the franchise relationship will also produce systemic benefits, economizing on the scarce judicial resources available for resolving other disputes where parties may not be in a position to structure a dispute resolution procedure in advance. Those scarce judicial resources are consumed not only when a dispute subject to arbitration is instead resolved in a judicial forum but also when parties, encouraged by anti-arbitration decisions like those of the Montana Supreme Court in this case, initiate satellite litigation such as this to challenge the enforceability of agreements to arbitrate. Even if the franchisor ultimately succeeds on appeal in enforcing the agreement to arbitrate, significant judicial resources will often have been spent on both the trial and appellate level in reaching that result.

However, these benefits of arbitration will be realized by franchisors (and franchisees), as well as the judicial system as a whole, only if state courts and state legislatures are reminded that attempts to undermine the en-

forceability of agreements to arbitrate, like Montana's, will not go unnoticed by this Court. Otherwise, state legislatures will be unleashed to formulate all manner of requirements for, and obstacles to, arbitration agreements, and the sound public policy that underlies the FAA will be subverted. Although it may seem theoretically possible for a national franchisor to track such rules and adjust the arbitration provisions of its contracts to meet their requirements, in practice this would prove extremely burdensome and probably impossible.

Even if national franchisors undertook the burdensome task of tailoring their contract documents to meet the varying and often conflicting arbitration laws of 50 different states, they would not be assured of having their arbitration agreements enforced, as this case itself demonstrates. A court—like the Montana Supreme Court in this case—may simply choose to disregard the parties' choice-of-law clause out of hostility toward arbitration and apply a state notice requirement or other state anti-arbitration law that the parties never expected, much less intended, would be applied to their relationship. Since a nationwide franchisor cannot anticipate in what state it might be sued or what state's arbitration statute might apply, it has no effective means of assuring that it can partake of the benefits of arbitration that Congress sought to promote by enacting the FAA.

What has been written above concerning franchisors is equally true for securities firms. Most of SIA's members do business in multiple states, some in all states. Firms use a universal agreement for all customers and expect them to be enforced equally in all jurisdictions. Montana, by singling out arbitration clauses for special notices not required for any other type of contract or clause, has created

costly obstacles to the ability to use universal agreements in the securities industry while also violating the purpose and intent of Section 2 of the FAA.

Furthermore, once a franchise agreement or securities customer agreement containing an arbitration clause is signed, it cannot be amended to comply with a subsequently enacted precondition to the validity and enforceability of the arbitration clause. It is far from clear under current law that such a legislative enactment would not be applied to a preexisting contract on the basis that it changed substantive rights, since a court could construe a dispute resolution provision as purely procedural in nature. Thus, the validity of tens of thousands of arbitration agreements may be made uncertain retroactively by the enactment of such legislation, resulting in extensive litigation to determine whether particular state-imposed requirements for arbitration agreements are preempted by the FAA. It is far sounder public policy to reiterate the long-standing and well understood rule that the FAA preempts any state requirement that segregates arbitration agreements from other contracts and imposes preconditions to their validity and enforceability that are not applicable to contracts generally. This Court should definitively and finally close the door to such state efforts to undermine arbitration agreements governed by the FAA.

CONCLUSION

IFA and SIA respectfully request that this Court reverse the decision of the Montana Supreme Court and remand the case to that court with instructions to enforce the arbitration clause at issue.

Respectfully submitted,

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No. 95-559

In The

Supreme Court of the United States

October Term, 1995

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,

Petitioners,

v.

PAUL CASAROTTO and PAMELA CASAROTTO,

Respondents.

On Writ Of Certiorari To The
Montana Supreme Court

BRIEF *AMICI CURIAE* OF THE AMERICAN ASSOCIATION OF RETIRED PERSONS AND THE NATIONAL ASSOCIATION OF CONSUMER ADVOCATES IN SUPPORT OF RESPONDENT

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STATEMENT OF INTEREST OF *AMICI CURIAE*

The American Association of Retired Persons (AARP) is a non-profit membership organization of approximately thirty-three million people aged fifty and older. In representing the interests of its members, AARP seeks to: (1) enhance the quality of life for older people; (2) advance the role and place of older people in society; (3) sponsor research on the physical, psychological, social, economic and other aspects of aging; and (4) support public policies to protect the rights of older people in a broad range of marketplace transactions.

AARP views alternative dispute resolution (ADR) as a valuable tool for resolving a range of conflicts. The Association is aware, however, that businesses increasingly are including standard language in contracts that requires consumers to agree to binding arbitration as a condition for gaining access to goods and services. Arbitration clauses severely limit customer redress options, yet individuals often are unaware of the existence of such clauses and their implications. AARP policy thus provides that "[v]oluntary arbitration, as a substitute for legal action, is appropriate in those cases where consumers, through informed consent, voluntarily and knowingly give up the right to court action in favor of arbitration." *Toward A Just & Caring Society – The AARP Public Policy Agenda* at 354 (1995).

Where ADR is appropriate, AARP believes certain mechanisms are necessary to help ensure fairness. Specifically, for mediation or arbitration, AARP supports the following safeguards: parties must receive reasonable notice, an explanation of the rules and consequences, and

an opportunity to consent to any ADR procedures; ADR cannot be imposed upon a consumer as a condition of doing business; arbitrators and mediators must be neutral, well-qualified, and trained in the skills of ADR; and mediators and arbitrators should not be affiliated with the business involved in the dispute. With respect to arbitration, AARP's policy also provides that: mandatory binding arbitration cannot be imposed on a consumer prior to a dispute arising; participants must be allowed to engage in reasonable discovery; evidentiary protections must be guaranteed to both parties, with a right to cross-examination; any decision must be in writing, including findings and reasons provided for the decision, and must be fully accessible to the public, except where the individual has a compelling need for privacy; and any constitutional issues raised or procedural errors must be reviewable by a court. *Id.* at 401-402.

The National Association of Consumer Advocates (NACA) is a non-profit corporation whose members are private, public sector, and legal services attorneys, and law professors and students, whose primary practice involves the protection and representation of consumers. Its mission is to promote justice for all consumers by maintaining a forum for information sharing among consumer advocates across the country, and to serve as a voice for its members as well as consumers in the ongoing struggle to curb unfair and abusive business practices. From its inception, NACA has focused on issues which involve abusive and fraudulent business practices, and has been concerned about the imposition by businesses of mandatory arbitration clauses on their consumers, because of the expense, limitation on discovery

and remedies such as injunctive relief, and inability to reverse decisions which are incorrectly decided and result in injustice. Consistent with its goal of promoting justice for consumers, NACA has appeared as *amicus curiae* in *Badie v. Bank of America*, Civ. No. AO68753, before the California Court of Appeals, in support of a challenge to the bank's attempt to impose arbitration on its credit card and deposit account customers by means of a notice inserted in their billing statements.

Amici believe that this case has far-reaching implications for people entering contracts in a wide range of contexts. A decision affirming the Montana Supreme Court will further the bedrock principle that enforceable contracts require the knowing, voluntary consent of the parties. This Court recognized that this principle applies to arbitration, holding that the Federal Arbitration Act (FAA), 9 U.S.C. § 1 et seq. (1988 & Supp. IV 1995), is intended to enforce arbitration agreements that parties have entered, not to require parties to arbitrate when they have not agreed to do so. *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 478 (1989). *Amici* submit this brief to illustrate how this Court's resolution of the present dispute will have a significant impact beyond the single franchise agreement from which it arises. This Court's ruling can ensure that parties to a broad range of transactions will be able to choose how disputes are to be resolved, fully apprised of the terms governing their rights and responsibilities under a contract. This Court's decision likewise can uphold the efforts of many states to ensure that their citizens are aware of contract terms that have a significant effect on their rights. An affirmance thus will not

undermine the FAA's purpose, but will further its goal of enforcing lawful arbitration requirements agreed to by the parties. *Volt Info. Sciences, supra.*

For these reasons, *amici* respectfully submit this brief in support of Respondent.[1]

STATEMENT OF THE CASE

Amici adopt the Respondent's statement of the case.

SUMMARY OF THE ARGUMENT

Alternative methods of dispute resolution, including voluntary arbitration, can play a valuable role in a variety of conflicts. These processes fundamentally change the nature of a cause of action, however, and effect a waiver of the right to a jury trial. It is crucial that individuals entering into contractual relationships are aware of how these and other important provisions will affect their rights and responsibilities. This is particularly true in standardized, boilerplate contracts, when the individual has little, if any, opportunity to negotiate over the terms. The Montana statute at issue in this case is merely an attempt to ensure that parties are aware that a contract contains an arbitration clause. The Montana legislature and those in other states have enacted similar notice and

[1] The written consent of the parties to AARP and NACA filing this brief have been filed with the Clerk of the Court pursuant to Sup. Ct. R. 37.3(a).

disclosure requirements with respect to other types of contract provisions to prevent surprise and to make sure that individuals, especially those with less bargaining power, give knowing consent to a contract's terms. These laws thus do not conflict with the underlying policy of the Federal Arbitration Act (FAA), but seek to further the principle articulated by this Court, that arbitration is a matter of contract and that the Act's main purpose is to ensure enforcement of private agreements to arbitrate. This Court also has said that the FAA's policy in favor of arbitration does not operate without regard to the contracting parties' wishes. A decision upholding the Montana Supreme Court will ensure the validity of agreements to arbitrate achieved through knowing consent.

ARGUMENT

I. FULL DISCLOSURE OF MANDATORY BINDING ARBITRATION CLAUSES IS CRITICAL BECAUSE THE PROCESS FUNDAMENTALLY ALTERS THE PARTIES' DISPUTE RESOLUTION OPTIONS

A. Arbitration Was Designed as an Option for Commercial Transactions and Is Premised on Consent

Arbitration generally is defined as the voluntary submission of a dispute to an impartial decisionmaker selected by the disputants for a determination reached pursuant to procedures chosen by the parties. *See* Aryeh Friedman, *The Effectiveness of Arbitration for the Resolution of Consumer Disputes*, 6 N.Y.U. Rev. L. & Soc. Change 175,

187 (1977). In addition, arbitration is viewed as a contractual matter, *see, e.g., First Options of Chicago, Inc. v. Kaplan*, 115 S. Ct. 1920, 1924 (1995) ("arbitration is simply a matter of contract between the parties; it is a way to resolve those disputes – but only those disputes – that the parties have agreed to submit to arbitration"); *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1216 (1995) (*citing Volt Info. Sciences, Inc.*, 489 U.S. at 479; "Arbitration . . . is a matter of consent, not coercion. . . . "); *AT&T Technologies, Inc. v. Communications Workers of Am.*, 475 U.S. 643, 648-49 (1986) (" 'arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.' . . . This axiom recognizes the fact that arbitrators derive their authority to resolve disputes only because the parties have agreed in advance to submit such grievances to arbitration.").

As a contractual matter, an arbitration requirement is subject to negotiation and acceptance or rejection by the parties. When the parties to a contract are fully informed and possess equal bargaining power, as typically is the case in commercial transactions, arbitration is an appropriate method of resolving disputes. And, where the parties have assented to the terms of an arbitration agreement, courts defer to their judgment due to a strong preference for using the dispute resolution mechanism selected by the parties.

The Federal Arbitration Act (FAA), 9 U.S.C. § 1 et seq. (1988 & Supp. IV 1995), is instructive in this context. Congress did not intend the FAA to infringe upon the states' authority to protect individuals from the forced surrender of their right to a jury trial. Rather, Congress

intended the FAA to apply to ordinary contract disputes "between merchants." Julius H. Cohen & Kenneth Dayton, *The New Federal Arbitration Law*, 12 Va. L. Rev. 265, 281 (1926). In testimony before the Senate Judiciary Committee, the chair of the American Bar Association committee that drafted the law stated that it was " 'purely an act to give the merchants the right or the privilege of sitting down and agreeing with each other as to what their damages are, if they want to do it.' " *Sales and Contracts to Sell in Interstate and Foreign Commerce, and Federal Commercial Arbitration, Hearing on S. 4213 and S. 4214 before a Subcomm. of the Senate Comm. on the Judiciary*, 67th Cong., 4th Sess. 9 (1923) (statement of W.H. Piatt, Chairman of the ABA Committee of Commerce, Trade and Commercial Law). Moreover, the Act's legislative history evidences an "implicit assumption that it would be invoked by commercial actors having relatively equal bargaining power." Jeffrey W. Stempel, *A Better Approach to Arbitrability*, 65 Tul. L. Rev. 1377, 1380 (1991).

Unlike the parties to most merchant-merchant contracts, however, individuals contracting for goods and services generally do not have equal bargaining power and are not fully informed of all relevant contract clauses. In fact, a marked imbalance in knowledge and power more often characterizes such contracts. When the party with superior sophistication, knowledge, and financial resources inserts a mandatory arbitration clause into a form contract, individuals usually are unaware of and have not consented to these terms. The Montana statute attempts to remedy that imbalance by requiring that an arbitration provision be referred to on the first page of a contract, and simply ensures that arbitration agreements

will be based on knowing consent. This eliminates the situation which occurred in this case, where the arbitration clause is buried on page nine of the contract and the individual is unaware of its existence and has in no sense agreed to such a provision.

B. The Right to a Jury is Fundamental in American Jurisprudence and Waivers of this Right Must Be Knowing and Voluntary and Should Not Be Presumed

Pre-dispute arbitration requirements imposed on an individual without notice effectuate an unknowing waiver of the individual's right to a jury trial. Yet, the jury has been called "the single most important institution in the history of Anglo-American law," Judge Morris Arnold, *The Civil Jury in Historical Perspective, in The American Civil Jury* 9-10 (1987), and many states recognize the importance of this right. *See, e.g.*, Mont. Const. art. II, § 26 (Mont. Code Ann. 1995) ("the right of trial by jury is secured to all and shall remain inviolate"), Cal. Const. art. 1, § 16 (West 1983 & Supp. 1995) (a jury trial "is an inviolate right and shall be secured to all. . . . In a civil case a jury may be waived by the consent of the parties expressed as prescribed by statute"), Okla. Const. art. 2, § 19 (1981 & Supp. 1996) ("[t]he right of trial by jury shall be and remain inviolate").

The waiver of such traditional, fundamental rights should not be treated lightly, and this Court will "not presume acquiescence in the loss of fundamental rights." *Ohio Bell Tel. Co. v. Public Utilities Comm'n*, 301 U.S. 292, 307 (1937). Further, this Court has stated that where due

process rights are at risk, waivers must be voluntary and knowing, *D.H. Overmyer Co. v. Frick Co.*, 405 U.S. 174, 185-86 (1972), and has defined waiver as "'an intentional relinquishment or abandonment of a known right or privilege.' " *Barber v. Page*, 390 U.S. 719, 725 (1968) (quoting *Johnson v. Zerbst*, 304 U.S. 458, 464 (1938)). A waiver should not be presumed where, as in this case, one party typically has superior knowledge and bargaining power, and the party waiving his fundamental rights has relatively little of either.

The use of arbitration to resolve a dispute drastically changes a cause of action, and individuals should not, through lack of disclosure, be forced to make unwitting waivers of their right to a jury trial without understanding the consequences. This Court has recognized that

> the remedy by arbitration, whatever its merits or shortcomings, substantially affects the cause of action created by the State. The nature of the tribunal where suits are tried is an important part of the parcel of rights behind a cause of action. The change from a court of law to an arbitration panel may make a radical difference in ultimate result.

Bernhardt v. Polygraphic Co. of Am., Inc., 350 U.S. 198, 203 (1956). *See also Alexander v. Gardner-Denver Co.*, 415 U.S. 36, 56-58 (1974).

Considerable differences exist between arbitration and traditional court adjudications, and the parties to an arbitration sacrifice numerous procedural safeguards guaranteed to court litigants in order to pursue an informal resolution of their dispute. First, a judicial proceeding is public, whereas an arbitration proceeding is

private. Second, the judge and jury are neutral decision-makers, while arbitrators are dependent upon the parties for their income and are not required to take an oath of fairness and impartiality. Third, court witnesses are sworn to tell the truth, while arbitration witnesses are sworn only upon a party's request, and rules of evidence do not apply. Fourth, discovery is available to parties in court, while it is not guaranteed to participants in an arbitration proceeding. Fifth, the trier of fact is required to follow the law and the parties can appeal errors of law and findings based on insufficient credible evidence, while an arbitrator's factfinding is final. These differences have formed the basis for holding pre-dispute arbitration agreements between parties of unequal bargaining power unenforceable under federal law when important rights are involved. *See, e.g., U.S. Bulk Carriers, Inc. v. Arguelles*, 400 U.S. 351, 356 (1971); *Barrentine v. Arkansas-Best Freight Sys.*, 450 U.S. 728, 742-45 (1981); *Alexander v. Gardner-Denver Co.*, 415 U.S. at 55-59.

Similar principles warrant a ruling that arbitration clauses should not be enforced where there exists an unreasonably high likelihood that an individual is unaware of the clause's existence and has not given his or her consent. As this Court has noted, "a party who has not agreed to arbitrate will normally have a right to a court's decision about the merits of its dispute. . . . " *First Options of Chicago, supra*, at 1923. Decisions of this Court give paramount importance to the wishes and intentions of the parties, recognizing that "the basic objective in this area is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes . . . but to ensure that commercial arbitration agreements, like other

contracts, 'are enforced according to their terms,' . . . and according to the intentions of the parties." *Id.* at 1925 (quoting *Mastrobuono*, 115 S. Ct. at 1214, and *Volt Info. Sciences*, 489 U.S. at 479).

Montana's Uniform Arbitration Act, Mont. Code Ann. § 27-5-111 et seq. (1995), specifically recognizes the enforceability of arbitration agreements. The law furthers the underlying policy that arbitration be a matter of consent, not coercion, by ensuring that individuals faced with standardized, non-negotiated, form contracts will know of the existence of an arbitration clause and knowingly consent to its terms. *Id.* at § 27-5-114(4).

C. Many Features of Arbitration Inure to the Benefit of Equals, But Are Extremely Unfair to Individuals of Unequal and Lesser Power

Some of the very characteristics that make arbitration an attractive alternative to litigation underscore the need to ensure that both parties have knowingly agreed to the process. In 1983 the National Institute for Dispute Resolution (NIDR) found that mediation, arbitration, and other means to settle disputes without attorneys and judges may "lead disputants to make choices they would avoid if they were better informed." This is especially true for "women, the poor, the elderly, persons for whom English is a second language, and other classes of disputants traditionally less powerful or less skilled at negotiations than their opponents." National Institute for Dispute Resolution, *Paths to Justice: Major Public Policy Issues of Dispute Resolution 15* (1983), *reprinted in* Administrative Conference of the United States, *Sourcebook: Federal*

Agency Use of Alternative Means of Dispute Resolution 5, 23 (1987) [hereinafter *ACUS Sourcebook*]. Moreover, poorer people and those with less experience may have more difficulty collecting and analyzing the materials that are "essential to 'predict' the likely dispute result and may be 'bought-off' by a comparatively low settlement offer that is less a reflection of the true value of a suit under the substantive law than the procedural strength of the richer or more experienced opponent." *See* Edward Brunet, *Questioning the Quality of Alternate Dispute Resolution*, 62 Tul. L. Rev. 1, 46 (1987) (citing Owen M. Fiss, *Against Settlement*, 93 Yale L. J. 1073, 1076-78 (1984)).

In addition to the effect this inequity may have on the outcome of an arbitration process, many features of the process itself work to the benefit of business, but to the detriment of individuals. These features include limited discovery, privacy, the absence of a written opinion or explanation of its basis, the choice of arbitrator and, for all intents and purposes, the finality of the decision. *See, e.g., Moore v. Conliffe*, 871 P.2d 204, 222-23 (Cal. 1994). In addition, Robert Raven, former American Bar Association President, has warned that "[c]ertain forms of private judging dispense with many of the most cherished and carefully developed features of our public system: open proceedings, written decisions, appellate review, and the evolution of the common law." Robert D. Raven, *Private Judging: A Challenge to Public Justice – A Message from the President*, 74 A.B.A. J., Sept. 1, 1988, at 8. President Raven made a compelling point with particular relevance in consumer disputes: "The potential dangers of providing one system of justice for the affluent, and another for everyone else, should stimulate us to improve

our system of public justice. This 200-year-old system with vital safeguards simply cannot be replaced with private judging." *Id.*

Whatever one considers the pros and cons of discovery in litigation, the extreme limits placed on discovery in arbitration generally favor corporate interests, to the individual's detriment. Absent discovery, individuals often will be unable to succeed on their claims because the corporation customarily will possess the information and documents vital to the individual's case. This lack of access to documents and deposition testimony will insulate the institution because an arbitrator will, at most, be able to review documents relating solely to the affected individual, and will be unable to examine underlying policies or fashion broader relief. Just and fair results of any dispute resolution process require mechanisms that ensure full disclosure of the facts. *See* Brunet, *supra*, at 34.

Arbitrators generally need not rule according to the law, and their decisions are not reversible even if they result in manifest injustice. *See, e.g., Moncharsh v. Heily & Blase*, 832 P.2d 899, 900 (Cal. 1992) ("[A]n arbitrator's decision is not generally reviewable for errors of fact or law, whether or not such error appears on the face of the award and causes substantial injustice to the parties."). Even in the limited circumstances in which a court can overturn an arbitrator's decision, because arbitrators need not explain the bases for their decisions or make a complete record of the proceedings, aggrieved individuals will be ill-equipped to satisfy their burden, e.g., proof in the record that the arbitrator "knew the law and expressly disregarded it." *See, e.g., Merrill Lynch v. Bobker*, 808 F.2d 930, 933 (2d Cir. 1986). Also, because arbitrators

do not have to issue written opinions explaining their decisions, businesses need not fear that unfavorable decisions will lead other people to sue on the same basis, or provide precedent that arbitrators or judges will feel bound to follow.

The privacy or confidentiality accorded arbitration proceedings generally favors businesses, which prefer that customer disputes remain free from public scrutiny. Concerns include the fear that publicity may lessen customers' trust and confidence in these corporations, and result in the disclosure of practices and procedures which, even if legal, the businesses would prefer to keep private. Mark E. Budnitz, *Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection*, 10 Ohio St. J. on Disp. Resol. 267, 285 (1995). The privacy factor seriously impedes the continued development of a body of consumer protection law. Individual consumers and government regulatory and enforcement agencies are limited in their abilities to take actions to protect the general public. The publicity following a verdict of fraud or similar action informs consumers about practices and institutions they may want to avoid. The inability of consumers to obtain information about the experiences of others increases the transaction costs for a consumer who seeks information about a company, and isolates the consumer. In contrast, the confidentiality factor allows businesses to control information, thus increasing their power. *Id.* at 327-28. *See also* Friedman, *supra*, at 199.

The choice of arbitrator can play a crucial role in the outcome of a dispute. Judges are subject to public scrutiny before and after their appointment or election, while

neither the public nor any governmental body plays a role in the process used by private arbitration organizations to determine an arbitrator's qualifications. While a party can avoid selecting an arbitrator he or she deems biased or unqualified, a "'repeat player' such as a large lender which determines the arbitration organization and uses arbitration frequently, however, has a decided advantage over the 'one shot' player such as the consumer. The repeat player is far more likely to know the persons in the arbitration pool." Budnitz, *supra*, at 293.

Moreover, unlike consumer cases, the more traditional commercial arbitration is likely to involve repeat players who risk less if they lose an individual case.

> '[T]he law of averages will insure that a party who loses one routine arbitration out of ten that he should have won will win one out of ten that he should have lost. . . . ' The injustice that results from an erroneous arbitration award rendered against a 'one-shot' player such as a consumer, however, may be very grave. The amount of money involved is usually far more significant to an individual consumer than a financial institution.

Id. at 322-23 (quoting Nicholas J. Healy, *An Introduction to the Federal Arbitration Act*, 13 J. Mar. L. & Com. 223, 224 (1982)). *See also* Dwight Golann, *Developments in Consumer Financial Services Litigation*, 43 Bus. Law. 1081, 1091 (1988) ("[A]rbitration provides a quick means to lose, as well as to win. This is not a major drawback for 'repeat players' such as financial services providers, who can recoup in one case what they have lost in another. It is, however, a

significant disadvantage for a 'one-time player,' such as a consumer.")

In addition, institutions that choose arbitrators from a for-profit company face an inherent conflict of interest, including the company's "pursuit of repeat business from high-volume customers." Healy, *supra*, at 294. Unlike judges, arbitrators "are paid by the parties, who consent to the process." Raven, *supra*. This leads to the possibility "that an arbitrator will make a decision with an eye toward his role in future disputes involving one or both of the parties – that is, an arbitrator's decision might be influenced by the desire for future employment by the parties." Kirby Behre, *Arbitration: A Permissible or Desirable Method for Resolving Disputes Involving Federal Acquisition and Assistance Contracts?*, 16 Pub. Cont. L. J. 66, 72 (1986), *reprinted in* ACUS *Sourcebook*, *supra*, at 371, 380.

Another purported benefit of arbitration is that except in very limited circumstances, a dissatisfied party cannot seek court review. This is viewed favorably in terms of finality and avoiding appeals that drag on for years. And, as with other aspects of arbitration, this is not a problem for parties who have made a fully informed decision to follow this path. The California Supreme Court recognized this, stating that:

> Because the decision to arbitrate grievances evinces the parties' intent to bypass the judicial system . . . arbitral finality is the core component of the parties' agreement to submit to arbitration. Thus, an arbitration decision is final and conclusive *because the parties have agreed that it be so*. By ensuring that an arbitrator's decision is final and binding, courts simply assure that the parties receive the benefit of their bargain.

Moncharsh, 832 P.2d at 903. The court's emphasis on the parties' agreement, and its use of the words "decision," "intent," and "bargain," illustrate a situation that simply does not exist in most consumer contracts and, by implication, demonstrates why the finality of arbitral decisions is inappropriate when one of the parties has *not* agreed to the arbitral forum or has done so without knowing the consequences of that decision. *See also Advanced Micro Devices, Inc. v. Intel Corp.*, 885 P.2d 994, 1001 (Cal. 1994) ("Were courts to reevaluate independently the merits of a particular remedy, the *parties' contractual expectation* of a decision according to the arbitrators' best judgment would be defeated." (emphasis added)).

Moreover, an unwitting consumer should not be left without recourse to challenge even a clearly erroneous decision. The risk that an arbitrator will make a mistake may be acceptable when "by *voluntarily submitting* to arbitration, the parties *have agreed* to bear that risk in return for a quick, inexpensive, and conclusive resolution to their dispute," *Moncharsh*, 832 P.2d at 904 (emphasis added), (citing *That Way Prod. Co. v. Directors Guild of Am., Inc.*, 158 Cal. Rptr. 475, 477 (Ct. App. 1979)). It is unacceptable to bind a consumer to an erroneous decision, however, when he or she did not choose or agree to the process by which that decision was reached. The California court proceeds to support its affirmation of the general rule that an arbitrator's decision cannot be reviewed for errors of law or fact with two statements that clearly assume a voluntary agreement to arbitrate. First, "'the parties to an arbitral *agreement knowingly* take

the risks of error of fact or law committed by the arbitrators and that this is a worthy *'trade-off'* in order to obtain speedy decisions by experts in the field. . . . " Second, "[w]hen parties *opt* for the forum of arbitration they *agree* to be bound by the decision of that forum *knowing* that arbitrators, like judges, are fallible." *Id.* (emphasis added).

All of these considerable differences between litigation and arbitration can have a substantial effect on the outcome of a dispute. This underscores the need to ensure that individuals who agree to submit a claim to arbitration do so voluntarily and with a full understanding of the consequences of that choice. The Montana disclosure law at issue in this case will help achieve such knowing, voluntary participation in the arbitration process.

D. States Recognize That Unanticipated Terms of Standardized Adhesion Contracts Must Be Called to the Attention of the Adhering Party to be Enforceable

State legislatures have long recognized that important rights may be affected by the small print of boilerplate contract provisions. Consequently, in order to protect individuals from surprise and to ensure that they have given knowing and informed consent to contract terms, many states such as Montana have enacted special requirements for the formation of adhesion contracts, which also apply to contracts containing arbitration clauses. John S. Murray, *Processes of Dispute Resolution: The Role of Lawyers* 453 (1989). These laws do not discourage parties from agreeing to particular contract terms,

such as arbitration requirements, but aim to ensure the clear disclosure that certain requirements exist.

States achieve this by dictating the content, point size, typeface, and placement of important contract language, or requiring that certain clauses be separately initialed or signed. For example, California requires eight-point bold red or ten-point bold type to draw attention to a liquidated damages provision in a real property purchase contract. Cal. Civil Code § 1677(b) (West 1995). California likewise requires that the words "Security Agreement" appear in at least twelve-point bold type at the top of a retail installment agreement where a security interest is retained in goods, and a notice in fourteen-point bold type, set apart from the rest of the contract by a border, and another similar warning just above the signature line, if an interest in real property is taken. Cal. Civil Code § 1803.2 (West Supp. 1996). Montana imposes a similar requirement for retail installment contracts, providing that the printed portion of the contract, other than the instructions for completion, must be in at least eight-point type, but that a notice must appear in at least ten-point bold type telling the buyer not to sign the contract without first reading it, that he or she is entitled to an exact copy of the contract he or she signs, and that he or she has the right to pay off in advance the full amount due and to receive a partial refund of the finance charge. If the contract covers the sale of a motor vehicle, a specific statement concerning liability insurance coverage for personal injury and property damage also must appear in at least ten-point bold type. Mont. Code Ann. § 31-1-231(2), (3) (1995).

Many states have adopted similar requirements governing arbitration provisions. In Missouri, for example, a written agreement to submit any existing controversy to arbitration and a contract provision to submit a future claim to arbitration must include, in 10-point upper case type, adjacent to or above the space provided for signatures, language substantially similar to the following: "THIS CONTRACT CONTAINS A BINDING ARBITRATION PROVISION WHICH MAY BE ENFORCED BY THE PARTIES." Mo. Ann. Stat. §§ 435.350, 435.460 (Vernon 1992 & Supp. 1995). In ruling that an arbitration clause that did not meet this requirement was unenforceable, a Missouri appeals court noted that the "apparent harshness of this rule . . . is mitigated by the legislature's bona fide concern that the voluntary nature of arbitration agreements be assured." *Hefele v. Catanzaro*, 727 S.W.2d 475, 477 (Mo. Ct. App. 1987). In Texas, arbitration clauses in consumer contracts where the total consideration to be provided by the individual is $50,000 or less are not enforceable unless the parties agree in writing to submit to arbitration and the parties and their attorneys sign that agreement. Tex. Rev. Civ. Stat. Ann. art. 224(b) (West Supp. 1995). California law also imposes strict disclosure and assent requirements for contracts to convey real estate that contain arbitration requirements, Cal. Civ. Proc. Code § 1298 (West 1982 & Supp. 1995), and contracts for medical services that contain a provision to arbitrate negligence claims require clear disclosures in at least 10-point bold type immediately above the signature line. Cal. Civ. Proc. Code § 1295 (West 1982).

II. PUBLIC POLICIES FAVORING ALTERNATIVE DISPUTE RESOLUTION SHOULD NOT OVERRIDE CONSUMERS' RIGHTS AND EXPECTATIONS

There are many reasons to support alternative dispute resolution in general, and voluntary arbitration in particular. Public policies favoring these mechanisms recognize the important role they can play as alternatives to litigation. These policies should not be used, however, to justify depriving a state's citizens of the protections of a state constitution, consumer protection laws, and other public policies. It is not at all clear that the wide array of remedies available under state unlawful and deceptive practices acts, such as injunctive relief and treble or punitive damages, would be available in arbitration, and it is unlikely that arbitrators would have authority to order cessation of unlawful practices or disgorgement of ill-gotten gains.

Moreover, given the importance of an individual's right to a jury trial and the other rights consumers forfeit by choosing arbitration, consumers are unlikely to expect or realize that the small print on a form contract contains a provision that effects a waiver of those rights. It is even less likely that customers would reasonably expect to have waived their rights before a dispute has even arisen. In fact, given portrayals in popular media and the likely prior experiences of the consumers and their relatives and friends, it is more reasonable to think that consumers would expect that disputes regarding their purchases and other transactions would be resolved in a court.

This Court has recognized the importance of balancing policies favoring arbitration against ordinary contract principles that require interpreting agreements so that they reflect the intent of the parties. While arbitration is accepted as an economical and expeditious means to resolve disputes, "arbitration is simply a matter of contract between the parties; it is a way to resolve those disputes – but only those disputes – that the parties have agreed to submit to arbitration." *First Options of Chicago, Inc.*, 115 S. Ct. at 1924. Moreover, "a party can be forced to arbitrate only those issues it specifically has agreed to submit to arbitration." *Id.* at 1925. *See also Victoria v. Superior Court*, 710 P.2d 833, 834 (Cal. 1985) ("judicial enthusiasm for alternative methods of dispute resolution must not in all contexts override the rules governing the interpretation of contracts"); *Freeman v. State Farm Mut. Auto Ins. Co.*, 535 P.2d 341, 346 (Cal. 1975) (despite the "strong policy in favor of enforcing agreements to arbitrate . . . there is no policy compelling persons to accept arbitration of controversies which they have not agreed to arbitrate. . . . ").

In addition to the tenets of basic contract law, public policy should not be used to deprive unwary consumers of basic principles of justice. California Supreme Court Justice Kennard, concurring and dissenting in *Moncharsh*, articulated this in refusing to "accept the proposition . . . that the general policy in favor of arbitration is more important than the judiciary's solemn obligation to do justice." *Moncharsh*, 832 P.2d at 920. The Montana law at issue before the Court has balanced those competing interests in favor of ensuring that enforceable arbitration provisions, like all other contract terms, are based on knowing consent.

CONCLUSION

Alternative dispute resolution mechanisms can have many advantages over litigation in a variety of contexts. These advantages are premised on a voluntary agreement negotiated by parties who are fully aware of the consequences of their choices. The magnitude of these consequences underscores the need to ensure that the parties to a contract are made aware that the contract contains an arbitration clause. That is all the Montana law at issue in this case aims to achieve, by requiring that notice of an arbitration clause be placed on page one of a contract. Such a requirement in no way conflicts with federal policies favoring arbitration; it merely helps to ensure that parties make knowing decisions about the contracts they enter.

For the foregoing reasons, *amici* respectfully request that this Court affirm the Montana Supreme Court's decision.

Respectfully submitted,

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